COMMON STOCKS AND THE AVERAGE MAN

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COMMON STOCKS
and the
AVERAGE MAN

BY

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Preface

IT is the hope of the author that this book will help to readjust our ideas on investment, which were rather seriously upset by the October-November 1929 stock panic. Not only was the average man or woman who invests bewildered by the revelations of the panic, but so indeed were also most of the financial economists and bankers themselves. It has already been dubbed the rich man's panic; the first notion that it represented an uncontrollable orgy by small speculators falling rather flat.

It is now plain that the stock panic was a major event in American economic life. It was full of significance, quite as much because of the rift it made in ideas which were current in both high and low circles, as because of the extent of the changes in values. It was a powerful corrective. As such it distinctly calls for acceptance of the correctives, after deciding what they are.

There are three distinct aims in this book: (1) to revalue our ideas of investment in the light of panic lessons; (2) to criticize the ideas and methods and leadership which contributed to

the panic causes, and (3) to offer a very highly simplified and useable manual of sound investment for the average man, based concretely on the admittedly attractive investments to be made at after-panic prices. In addition it is the purpose of the author to emphasize the place of the average small outright investor in common stocks, now shown to be more important than ever. A calculation made after the panic showed that twenty large corporations had 37% more stockholders than they had just before the panic.

Although in part critical this book is entirely constructive in plan. We are today beyond the time when it was *lese majesté* to be critical of those in high places of finance. It is a fact not to be gainsaid that financial leadership was defective for a year or too prior to the panic, and that few, if any, had any clear idea of the unsound nature of financial conditions and ideas current before the panic. Lord Birkenhead has said in England that on his visit here during 1929 no financial leader appeared to have any conception of what was coming. The rich and the heads of many financial institutions were humbled equally with the ordinary investor, and my statement that they were deficient in analysis and wise leadership is by no means a lonely one. Even so usual a defender of business as Mr. Bruce

Barton has said that the panic represented a failure in financial leadership. The tradition of banker omniscience and superior economic wisdom is definitely broken. Modern technical business management is shown to be superior, since fundamental business conditions are excellent and the technical advance of business remarkable. Business has been notably free from a speculative or inflated position, while the financial world was in an astonishingly over-inflated situation. In the same way labor and the average man, in harmonious partnership with efficient management, has come out with flying colors.

The future of finance is definitely theirs. The ground is thoroughly fallow now for an inventory of ourselves and our investment methods and policies, and our ideas of valuation, all in the light of the future of wider still distribution of common stocks. I trust that this book will be of some use toward this end.

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BOOK ONE

Chapter I

The Average Man and His Money

THE axe has fallen and beheaded the joy-riding average speculator. The October-November 1929 stock panic came near doing to many average investors what the great war did to the French peasants who owned French Government bonds. As in that case, it has given a severe set-back to the average man's interest in stocks. Indeed it was reported that the "Big Six" bankers deliberately aimed, during the panic, to discourage the small speculator from taking any more interest in the stock market for a long time to come.

Now is the time therefore to re-analyze for the average man or woman—while the subject is sorely in their minds—the whole subject of buying of stocks, particularly common stocks. The

time is red-ripe for it, because few would listen to clear-headed thinking on this subject before the 1929 stock panic, but are now in the mood to learn. As Prof. John Dewey, the noted philosopher, says, people do not really think *until they are perplexed.* Out of their perplexity comes their reasoning and their wisdom.

The situation is extremely serious, far more so than the panic alone brought about. The American average man or woman is at a genuine crossroads as regards investments. Will he lose interest in stocks and become merely a savings bank investor? Will he become a bond buyer like the average Frenchman, or will he lose interest in saving altogether and tell himself that the money he lost in the stock market he might just as well have spent in wasteful or luxurious living? The whole trend of America's economic history for the next dozen or twenty years is bound up in the reply that the average man or woman is going to make to this question. He has had a profound shock and he is honestly perplexed. He is certain to make decided changes in his ideas. What will they be? He was led into dangerous ways and points of views and he has had a costly lesson; but a lesson about what? If he makes up his mind that the lesson is that he should leave common stocks alone, a very re-

markable change must take place, for we have been building American industry, yes even American civilization, for a dozen years on the basis of ownership participation by the average man. If he makes up his mind that the lesson is to invest only in bonds as the proper thing for the average men, the complexion of the financial world will change again, because the bond market has fallen rather low. If he makes up his mind that investment trust stocks are what he should buy, then these already large and numerous, but slightly dubious institutions will loom very much larger still. If, perchance, he should make up his mind that he is tired of trying to save and invest at all, since he has lost so much of his investment, then we will surely be at a bad turning.

It is extremely important, then, that the average man and woman should, just at this particular time, contact with a balanced, well-digested point of view, but a view that is modern and not merely reactionary; a view that is not afraid to lay blame at the right door and speak up valiantly in the average man's interest. It is the simple, usual procedure, after such a stock panic, to sound the bells to go back to the old-time super-safe methods of investment, bonds and savings banks, and toper-like, swear off every last bit of speculation. "When the devil is sick,

the devil a saint would be." After a while the pendulum would swing, as always before, toward speculation, since it is an ineradicable element in human nature, especially American human nature; working itself in due time to the same old high pitch, under one pretense or another. This is very human but extremely illogical, and it is certainly not the fault of the average man alone. It is a rank injustice to the average man to say that "the public indulged in a speculative orgy that couldn't be stopped." The "public," the average man, was far from alone to blame; indeed was not even the chief culprit. The entire banking and business world was in like degree guilty of the subtle but familiar old poison of inflation; and these financial men who now talk with superior airs about the stupidity and gullibility of the average man should pin these tags upon themselves. Almost the entire financial world developed a "complex" of millenial ideas that rose to greater and greater heights of self confidence; indeed to such heights that, like old-time kings and conquerors, it believed itself to be virtually invincible. It invented a special doctrine to explain itself; "the new era" (about which I shall later have something to say). *This was not the average man's doing;* it was the belief of a majority of bankers, economists and

statisticians, and the subject of learned discourses. The average man did nothing worse than follow the leadership of those to whom he had a right to look for leadership.

To put it bluntly, it was the most subtle, long-continued and well-reasoned financial self-delusion that has ever been known in any age; *all the more so because it was, and is more than half-true.* There is the rub: the half-truth is now in danger of being sunk along with the part which was pure self-delusion, and instead of having a wrong situation righting itself, we are likely to have a wrong situation wronging itself.

The entire matter focuses down *to the proportions with which we mix investment and speculation.* I mean that having indulged in what was, in all truth, 90% speculation and only 10% investment, we are now, in our usual extreme pendulum fashion, swinging back to 90% investment and 10% speculation—and, even beyond, to no investment and no speculation at all! And just at the time, too, when genuine investment-speculation is most sound and attractive! The truth—as usual—lies midway between: the average man should hold firmly to his real, logical basis, which is 60% investment and 40% speculation, or more conservatively a 70-30 ratio. But doubtless critics will now assail this as too

much speculation for the average man, whereas only a few months ago they were pooh-poohing all opinions that speculation beyond the extent of 40% for the average man was too much. The average man—at the very moment when wonderful investor-speculator bargains are lying about waiting to be bought—is doubtless saying "never again!" and refusing to buy common stocks at all. Sometime later when values will again very markedly be on the upward trend toward inflation he will buy and once more burn his fingers. This is the lamentable cycle of paradox of the average man who follows crowds and the urgings of ambitious bankers instead of using his brain; *the tragedy of inadequate and partly incompetent financial leadership offered to the average man.*

The sound, modern and competent point of view for the average man is to regard himself *as an investment-speculator, with the emphasis on investor*. He should buy very well selected common stocks *outright* for long-time holding, spread over a number of different industries, and seasoned with a proportion of preferred stocks or bonds, depending on the size of his surplus. If he should set himself firmly in this mold, of *investor-speculator,* and refuse to be enticed out of it under any circumstances or at

any time, we could cut out this cancerous disgrace to America of stock panics and ridiculous inflation (which in our pride we had said we had already conquered in the "new era"). No country in the world, in peace time, races its values up and down so disastrously; and it is high time that, in our new role of international financial center, we show that we have the character, leadership and stability to hold ourselves within the bounds of facts and good sense. Particularly should we develop more able leaders of finance who can and will exert their influence effectively in curbing the less able and less sound-thinking individuals in the financial world. Responsibility for the 1929 stock panic can be laid, in the measure of at least 60%, to the unwise financial standards of men in positions of financial responsibility. I resent, in the name of the average man, who is blamed for the speculative spree, the "passing of the buck" to him. The public does not speculate, nor the average man over-buy unless he is invited and stimulated and enticed by the organized and widespread efforts of the financial world. The average man has not been rightly used by a large portion of the financial world, and it does no harm to admit it. Any plan to make a sheer speculator out of the public is dangerous and takes on the

character of a boomerang, as was proved by the terrible avalanche of a grand total of over twenty-five millions of shares of stock traded in on all exchanges in one day of the stock panic, when there was no finding of the bottom of the market. Retribution came swiftly upon all concerned.

The average man cannot in the nature of things be a true speculator. This is basic and unchangeable. To the extent that he or the financial world subscribes to the idea that he can, there is bound to be catastrophe, no matter how long postponed. But equally true is the companion statement, that the average American must not be herded into a mere investment nursery without opportunity to share in the growth of the country. The average man *has never properly mixed the two elements of investment and speculation,* which are the Siamese twins of finance. He is like the wilful boy who always eats either too much fat or too much lean; too much candy or too many green apples. Yet the "average man's" *average status* as to his surplus—and this includes men and women who have from $2,500 up to $100,000 to invest—absolutely pre-determines the ratio of speculation he may permit himself, if he is to act soundly. Some have rigidly held to investment

only, and others to speculation only, or else a very small percentage of one mixed with the other.

In the same way the financial world has been divided into two camps. One camp egged on the average man to pure speculation by flooding the market with an outrageously vast quantity of new stock issues, and by general bullish encouragement on the very edge of predictable credit bubble-bursting. The other camp discouraged all speculation and stressed bonds, preferred stocks and savings banks as the only proper investment for the average man.

Neither are right. The average man should be encouraged to buy good common stocks with a portion of his surplus, on the same sound *principle* that the rich man uses, even if not to the same *degree.* This principle is basic, and not even a stock panic can shake it; namely, that anybody and everybody with investable surplus above a minimum sum should be privileged to share to a degree in the natural growth of the country—which it has been proved over and over again is best, if not alone reflected in good common stocks. It is equally a crime against the average man to try to withhold this opportunity from him, on the one hand, or to load him up with too much of it, on the other. It is still

another crime against him, on the part of those who function as financial advisors, to withhold from him plenty of education as to how he is to attain the correct investor-speculator balance with his surplus.

The average man's path upward with his money has been rocky and stormy. At one time he was entirely ignored by the banker, and he naturally fell among thieves—the fake stock promoters. Then, disillusioned, he dropped investment and even saving for a time and indulged in every kind of luxurious living. Pushed by Liberty Bond sellers he again became a security buyer on a larger scale than ever, and then, the war over, he once more went in for automobiles, radio and other merchandise on a great scale, even by instalment purchase. His surplus increasing, he began at last to appreciate the value of good common stocks and to buy them. For the first time in the history of the average man he was a sound speculator; I mean a buyer of stocks which really gave him a chance to grow with the country. This he did by employe stock ownership and by share purchase. It was a great and fine development, of real service to industry and a millenium for the average man, because it made him a partner in industry. So revolutionary was it that it set up

a mass of rainbows in the sky for a certain type of financier. It tempted such to overload the market with a huge volume of stocks of every kind, and this naturally induced those interested in selling them to press the average man to speculate. To do this, certain justifiable facts about a "new era" were glorified and expanded into an attempted remodeling of fundamental principles of finance. This has brought disaster, and this alone.

What now of the average man? What of the progress which was made? What of the genuine advance toward a "new era" which was made—and now seemingly sacrificed? The idea of reverting to the old swinging of the pendulum is unthinkable and crude: inflation-deflation; unrestrained speculation—then penitently back to the savings bank. It is destructive and character-debilitating—*and unnecessary.* Action should be taken at just this time, when the average man's buying time is at its height, and when the right balance between the old and the new can best be struck. The average man should by all means own common stocks; he will never be a true partner in industry until he does; but he should own them out-right. The average man is in no danger if he is to a limited degree a speculator by such outright purchase. The en-

tire program of sound capital-labor relations is bound up in this, for hundreds of thousands of employes today own shares in their employing corporation, and this ownership suffered little by the panic. To disillusion them thoroughly about common stocks will strongly tend to disillusion them in their *esprit-de-corps*, so markedly improved by employe stock ownership.

But this is only a small part of the evil of such disillusionment. The average man, after suffering stock losses, tends to believe that he has been a lamb shorn of his savings by the "wolves of Wall Street." He does not usually discriminate between just criticism of the technique of certain elements in the financial world, on the one hand, and the more conscientious part of "Wall Street," on the other. He tends, as he has for decades past, to lump all the financial world into one and characterize it. On a long "bull market" when he saw his stocks climbing, he naturally relaxed any feelings of antagonism; but they easily flare up again and take on a political character. This was fully illustrated in the debates in Congress during the panic, led by the satiric Borah and the introduction of a bill for Federal registration of stocks and compulsory publication of quarterly full information.

We must proceed soundly with the program of common stock ownership by the average man and woman, for this policy is absolutely basic in the kind of civilization we are building in America. It is the one effective answer to class war, turmoil and unsound economic doctrines and antagonisms. It is a veritable cornerstone of modern capitalism and economic progress.

Chapter II

What of the "New Era" Now?

BY far the most significant thing that the October-November 1929 stock panic did was to put "the acid test" to the so-called "new era," which even some economists and many financial leaders had proclaimed. The excitement centered about the losses and the rapid drop in market values, but to the man who thinks, the real question it raised was, *what has happened to the ideas about a "new era?"* Were these new era economists really "jazz" economists as after the panic they were scornfully called? This "new era," like the Great War, has been made an explanation for anything and a spring-board for any theory one might have. It was the cue to many to drop all old-time standards and set up anything new that was

convenient and plausible. The "new era" was all rainbows and sunshine, and was bomb-proof, according to some. Wiseacres now recall that prophets of a "new era" usually appear just before a panic "deluge."

Many of these new era standards have now been utterly shattered. At the same time a very substantial part of the "new era" standards have weathered the storm, and are thus more firmly entrenched than ever. It would indeed be a calamity if these standards had also perished.

All too easily, newspaper writers said, the "new era" went to smash, like a crushed egg. Surface thinkers readily agreed that the so-called new era was a mere hasheesh dream of yesterday—a fairy tale told "before the great deluge," and of no meaning today.

This is mere emotional thinking and weather-vane analysis. It is giving altogether too much weight to market fluctuation, whereas no greater truism ever was said by financial wiseacres than that *market fluctuation does not either make or destroy intrinsic value.* There is no value which existed in stocks in August 1st, 1929 that did not also exist there Nov. 15, 1929—"after the deluge." The same measuring stick that a thinking man used then he should use now; and the

same general fundamental business conditions—all economists agreed—existed Nov. 15 as existed August 1st. It is obvious, then, that the only difference is a psychological one; and therefore *the only standard of value which has been altered is a psychological value.* "Panic psychology" is the widely agreed upon name that can be applied to the 1929 stock panic. The specific proof lies in the precipitate nature of the drop, and in the fact that the "panic" came during the absence of fundamentally bad business conditions. Other panics came more slowly and were based on bad fundamental conditions easily traceable in heavy, slow-moving stocks in dealer's hands, over-production, unemployment, etc. The stock panics in such years were reflections of bad fundamental conditions.

But not this last panic. It was purely a state of mind, reversing a previous state of mind. There had been recognition by very sound, conservative economists that there really was a new era. What then happened was that the unrestrained optimists, the opportunist bankers, the greedy stock promoters and the unthinking public began, pell-mell, to *discount* this new era for years ahead, *and over-reached themselves.* The new era set up new standards, but the unthinking seized upon them as license to indulge

in unrestrained imagination and unlimited standards of valuation. Instead of setting about to *fix the limits* of the new standard and thus give it measure and soundness, the occasion of the loosening of the old standards was taken to kick out of bounds all limits and recognize only the sky as the limit. A little like the so-called "younger generation," released from "old Victorian standards," certain groups which had no sense of proportion "went the limit" and refused to recognize any fixity of standards. The old is gone—the new standard is anybody's; this was the prevailing philosophy.

Now that the underlying laws of measure and proportion have had their way (or to put it in the words of the old Wall Street saw "what goes up must also come down"), we are face to face with reality. But will we pay attention to it? This reality is not that we must all suddenly turn ourselves from sinful "speculators" to saintly "investors," but that we must realize what is a proper blend of the two. The reality is not that there never was a new era except in our imaginations, but that we exaggerated and distorted this genuine new era. The reality is not that we are plumb back where we started from in 1920, but that we are now definitely off

of a detour which we were mistaking for the main road.

How did this "new era" develop, and what is meant by "new era?"

A very peculiar thing about it is that we didn't know we were getting into it until we were well in it. Nobody forecasted it; nobody knew it had arrived until it was merrily under way. I believe it first showed its presence in that great paradox which Hoover calls a modern economic miracle, namely *when wages began to increase while prices declined.* This, frankly speaking, is "economic law" standing on its head; but it kept right on doing it.

Like a comet in the sky, this phenomenon was first observed about 1922, after we had recovered from the stock market crash of October 1919, the effects of which lasted until 1921, because of the tremendous liquidation of stocks and the declining levels of prices of goods. Then the heads of American industry saw the wisdom of doing everything possible to keep wages high in spite of falling prices, so as to keep buying power going. *This was the real beginning of the "new era."* It was rooted in far-sighted appreciation of the new doctrine of *"consumptionism,"* or the idea that we must look upon the average man not merely as a producer and

worker for the purpose of industry, but even more so *as a consumer of the goods that industry produces.*

This new era was clinched and riveted in 1925 by the declaration of the American Federation of Labor that the first duty of labor is to increase production if it wishes to increase wages. This surely was a new era! You have only to contrast it with the famous "ca'-canny" policy of labor in England in recent years—the policy of doing as little work as possible—to see how inevitably our new era policy of consumptionism means more prosperity and purchasing power; how our "expansible wage" policy (more wages for more production) means more prosperity than the "living wage" policy (fixing wages permanently at cost of subsistence).

There is certainly no possible sign that we are going back on this *New Era Standard Number One,* just because of stock price fluctuations. But this was by no means all of the new era. It was indeed just a foundation to build on; a new *wealth-producing* foundation, of immense significance to the stock market. Why? *Because there are two kinds of consumption which were stimulated by higher wages and lower prices.* One was the consumption of *goods,* and the other the consumption of *securities.* People

don't want to buy *things* with every penny of their income. They can't eat more than a certain amount of food, wear more than a certain amount of clothes, or buy more than a certain amount of other goods. Like the rich man, the *average* man began, in this new era, to have *surplus funds* that he didn't want to spend for goods. He wanted to make his money work for him; he wanted to own stocks and bonds, as well as radios and automobiles. The average man became smart enough to grasp that he had *two* ways of earning: (1) by his own daily labor, and (2) by the earnings of his securities. His employer greatly aided him in attaining this new era knowledge, by inducing him to buy stock in his corporation.

This is *New Era Standard Number Two;* the financial awakening of the average man, and his possession of surplus to do it with (arising from *New Era Standard Number One*). Are we going back on either one of these because of a severe stock price break? It is not difficult to say no, we are not. The fairly rapid partial recovery of the stock market, after the "panic," and the large immediate volume of odd lot orders to buy outright for cash at bargain panic prices proved this thoroughly. The average man —as I distinguish him in this book from the

miscellaneous public rabble—was not ruined and broken by the stock panic, and he is quite as much convinced as ever—and so is every thinking economist—that he should continue to buy good securities, particularly good common stocks.

The next factor in the "new era" was the new Federal Reserve System which has functioned only since 1921 without war-time upset. Does anybody wish a return to the old system? Decidedly no, because it has come out of the "acid test" of the stock panic with higher prestige than ever. It is vindicated of the sharp criticisms made by banks and others. In 1926, and in each successive year the Federal Reserve Board called attention to the facts that the banks permitted so large a portion of their assets to become "frozen"—through affiliated financing companies and "groups" as issuers of investment trust stocks, etc. The stock panic has demonstrated the greater soundness of the Board's point of view, and if it can be criticized at all it is because it was not firmer and more forceful in its leadership to secure acceptance of its point of view. Bankers tried very hard to have the ultimate reserves of the country, with the Federal Reserve banks, placed at their disposal. They tried to stop the Reserve banks from mak-

ing a market for Government securities. They have sanctioned and practiced the habit of borrowing from Reserve banks on their direct notes, to get funds for relending to speculators on the stock market, thus restricting the credit for ordinary business purposes to some degree, even though not greatly. That we have a Federal Reserve system which is wise enough to resist this is certainly a "new era" asset whose strength we want to *increase* rather than decrease. We would have had a *business* panic, not merely a *stock* panic, had it not been for the Reserve system, that is certain.

So, *New Era Standard Number Three* is something we want by all means to hold on to, just as we do Numbers One and Two.

What is *New Era Standard Number Four?* It is the higher stability and lower investment risk of the best business corporations, thus making their securities, including their common stocks, a much better type of investment than the word "common stock" has ever meant, as a rule, in the past. This development, also crystalizing since 1921, has a very solid foundation of fact due to four major factors. First, the entirely new concept of sound management, which now prevails widely; management not by a "Napoleonistic" owner or big boss who rules

arbitrarily, often by family or ownership favoritism, but management on a basis of merit, and the line and staff system of functional organization, with each departmental executive on a high professional plane of dignity and full authority and responsibility. The last shake-out of the old system, which dangerously placed too much technical responsibility upon one individual, was seen during the 1919-1921 years of deflation, when such individualistic executives were found with far too heavy an inventory, based on raw material speculation ideas. The American Woolen Co., ruled autocratically by Wm. M. Wood for years and on a highly speculative basis, was an excellent example of what is meant, as were many other old-time corporations. *A genuine new era arrived when it was generally seen and admitted that this one-man method was a fallacious type of management.* Our ideas of executive functioning and organization have never been the same since, and the merit system in particular has been more firmly established.

Second, has been the merger technique, which has remade business organization—not, as in times past, consolidating to eliminate competition or to control the market and prices, or even to reduce production costs, but consolidation to do a better selling and distributing job, and to

give the public more value and service, based upon more research and closer relations with the consumer. This has had a particularly important effect in creating strong corporations whose common stocks are securities of real value and stability. The U. S. Steel Corporations common stock today has a value and a stability far beyond what it was 20 years ago and entirely aside from the earning power of the corporation. This is due to the changed status of common stocks in general, based upon the greater number of strong corporations of today which have a record of stability and strength. Prior to 1905 there was no such widespread record of corporation strength and stability.

Third, has been the greatly changed public temper toward large corporations; the passing of government persecution and fanaticism and fear about large corporations. This has markedly bettered the risk factor in corporate investment. With this must be calculated the far greater employe good-will and productiveness, and the closer relationship established with the consumer through sound advertising and selling policies, and the widespread acceptance of the mass production, low price, wider sales principle of operation, which makes for public good-will.

Fourth, has been the remarkable accomplish-

ments of industrial technique, research and co-operation, which have strongly tended to make technical advance and knowledge open to all through patent pools, engineering committees for joint research, standardization programs, waste reduction, trade association or "institute" cooperation to creatively develop consumption, or through Federal Trade Commission "trade practice conference," Better Business Bureaus, etc. which have very markedly raised the ethical standards of trading and abolished the rawer frictions of competition.

Here then we see *New Era Standard Number Four;* the bald and easily provable fact that common stocks of the representative large corporations of today have a much lower ratio of risk in them than common stocks ever had before in the history of business. So critical an economist, unaffected by American psychology, as J. Maynard Keynes, has admitted "the greater safety of the ordinary share" of today. Is this new era standard to be deplored, or has it been ruined by the stock market panic? The obvious answer is no. The very panic itself has increased now the stability and strength of representative shares.

We come now to the crux of the new era's standards, the standard of measurement of com-

mon stock values. *New Era Standard Number Five*—that *twenty or more times earnings* is not an inflated valuation for ordinarily good common stocks, is sound. *This standard is ruined absolutely.* It is the real casualty of the stock panic; fittingly because it was the real culprit. If a genuine, fair, restrained sense of measure had been applied to common stock values, there would have been no bubble of inflation to burst. But there was too wide a disagreement even among authorities as to what that fair measure should be, and this seriously mislead the public. *The doctors disagreed and the patient nearly died on the operating table.* Under the circumstances it is ridiculous to blame the public for speculation-madness. There was uncertainty and confusion among the bankers and economists on this vital matter of what is the sound ratio of valuation of earnings to market price. If it had been cleared up vigorously by some degree of agreement among the experts, there might have been far less of a panic. In the next chapter I shall take up in careful detail this subject of the ratio of market price to earnings, as it is very vital to the average man to know how the stock panic has corrected the ideas which have prevailed.

New Era Standard Number Six, that bonds

are no longer the safe and advisable investments they have long been regarded, and that common stocks are superior long-time investments. This is one of the most striking of all the new era standards, and one which is still in controversy, but I do not believe that it has been shattered by the stock panic. It still remains as true as when Smith proved it* that a buyer of bonds is really betting that the value of gold will not change; that the purchasing power of the dollar will not change—when, as a matter of fact it has very seriously declined, without much prospect of decrease in uncertainty. The bond owner has not been able to get back his real original investment, (in purchasing power) to say nothing of sharing in the growth of the country. There are, even after the stock crash, few who dare dispute these facts about bonds, and it would therefore be impossible to prove that *New Era Standard Number Six* had been more than dented a little by the deflation. It is a fundamental statistical factor which is not easily shatterable. The fear of bonds has not been driven away, and the fact that bond buying, even in diversified lines, is really putting your eggs in one basket, the gold dollar basket, is not disputable. Common stocks

* "Common Stocks as Long Term Investments" E. L. Smith; Macmillan.

have come out of the scrimmage *on top,* and there are no signs of a real or permanent boom in bonds.

New Era Standard Number Seven, that investment and speculation are not two separate things, but are one and indivisible, *has not been destroyed.* Investment, even in bonds, is also, unavoidably, speculation, and the two are twins. There is nothing to prove that this principle is not as sound now as ever. That is why I insist in this book that the average man and woman be regarded as investor-speculators, and be permitted to share in *sane* investment-speculation, on the same basis as the rich man. The fact that a portion of the public and the financial world went on a speculative spree does not prove that the average man or woman is incapable of learning to use sound investment-speculation methods. You might quite as justly say that the financial world should abdicate because it made serious errors of judgment in not anticipating the panic. In fact, the stock panic was an effective education for both the public and the financial district. It does not prove that the average man or woman must leave the stock market to the downright speculators and rich men. It only proves that when the character of *investor-speculator* is dropped for the character of specu-

lator, by anyone except professionals, the result is bad.

New Era Standard Number Eight, that "the market" has a unified action, and "cycles" of inflation and deflation are delusions, *is proved to be wrong.* This is the *second* of the New Era Standards to go overboard. The "market" certainly has acted in unison as perhaps never before, and the cycle of inflation has been shown to reach a point of thorough deflation. That it was a deflation only of stock valuations and not a merchandise or price deflation does not change the fact. That it is "*always* time to buy good stocks," whatever the market price, and that the day of "bear" markets and severe stock crashes is over, is shown to be an error. The "cycle" theory is certainly not yet outgrown in America.

New Era Standard Number Nine is that fiduciary institutions, such as insurance companies, savings banks and trust companies should carry most of their investments in common stocks. Despite the statistical facts of the superior investment possibilities of common stocks, the tremendous fall of prices—representing the definite speculative element of common stocks—proved that this is too dangerous for the guardians of the funds of the very poor who cannot afford even to be investment-speculators. This

new era standard is stamped by the stock panic as unsound, because fiduciaries (as the Armstrong Committee of 1906 pointed out) should not by common stock purchase acquire ownership interest in other businesses. The poor man's refuge should be based on absolutely stable *prior-lien* investments, not on anything speculative whatsoever.

New Era Standard Number Ten is possibly the most pivotal of all; the standard that promotion and high pressure salesmanship in all their ramifications can build soundly in business and finance. This Standard is now overthrown, and it is certain to have wide repercussions. Its roots go deep, and doubtless all of them can never be erased from American character. But business and finance have now to face the fact that the brand of salesmanship and promotion which has been used is hollow and crashes like an egg-shell when driven to its logical conclusion, as it was in the inflation of values, on mere "prospects," before the stock panic. *Too superficial a view of "salesmanship" and "promotion" was taken by too many people.* Instead of genuinely creative salesmanship we have had high pressure "drives" and optimistic delusions as to how hard we could stimulate the public, and the market. Instead of a promotion activity se-

curely related to inherent values we have had a mere ballyhoo contest. These errors have been shared by industry and finance alike. Let H. Parker Willis, editor of the *New York Journal of Commerce* who is also a noted financial expert, paint the picture: "financing companies affiliated with banks, not content with bringing out new issues, some of which have had anything but a solid basis, have also allowed themselves to begin the distribution of common stock, accumulating them by purchase in the market, then working them up to a higher level, then recommending them to their customers, and then distributing them, with assurances that they would hold their value. It becomes plain how widely our bankers of the present day have departed from the principles and practices of banking as have been known in past years."

John Moody, another famous financial authority, also speaks bluntly about the investment trust promotion movement. "It is of course the general notion," he says, "that the stock market crash was due entirely to the enormous amount of margin trading in standard listed securities at over-inflated values. This notion is far from the actual truth. The flotation of an ever-increasing number of the newer types of trading and holding companies and so-called investment

trusts has continuously absorbed credit and, more than any other thing caused the mounting totals in brokers' loans."

Another chapter was the hectic desire to create more and more mergers, irrespective of whether or not they were sound. New issues of stock, new purchases of companies were kept going in kaleidoscopic fashion until it was impossible to tell from the figures whether a company was making money or losing money because the new acquisitions of new stores in a chain, or new companies merged into a group covered up the truth. The new financing often discounted the growth of the company for years or decades ahead; the idea being to "sell" the investor in 1929 the company's probable accomplishments in 1935. This is just plain high-pressure salesmanship, of most doubtful ethical standard, with the sky as the limit, and was a New Era Standard which could not stand the test.

If anyone needs proof of the high pressure selling in finance, it is only necessary to look at the positive deluge of securities poured upon the market. In the first nine months of 1929 nearly 10 billion dollars worth of new securities were issued; over 1½ billions in September alone; a record.

All high pressure salesmanship, including the

over-playing of the instalment selling device, has received a blow, and is rendered obsolete. The chain store's feverish addition of more stores is now known to be a mistake; the hectic over-running of the country with direct-selling salesmen, or the heavy reliance on "pepped up" personal salesmen in any field is shown to be an inflation. The inflated program of some public utilities and their astounding methods of trying to influence the public through hidden propaganda in schools, purchase of newspapers, etc. is given a severe reproof. The insolent use of the telephone to contact with strangers without invitation by stocksellers and even by others is reprimanded. It becomes clear that real salesmanship must consist in paying attention to the genuine fundamental welfare and interests of the average man and woman and in the cooperative, rather than the shrill competitive working out of service to that end. It is now certified that the average man and woman, if they are successfully driven along by the Coney Island ballyhoo of high pressure salesmanship, to a high point, *suddenly make a panicky nose-dive straight down to earth,* with an instinctive realization that they are being "bamboozled"—no matter how much crashes, and no matter how "sound" general business conditions are. It is

proved that there is a distinct limit to which high pressure salesmanship can "drive" its customers; then they rebel or get frightened, and it were better that they had never been "driven" at all.

New Era Standard Number Ten is thus discredited when applied to finance, and had already been partially discredited in the merchandising world, for both the number and the importance and power of personal salesmen had been declining, since 1919, and more basic educational methods used by the successful companies. I am myself the author of standard works on salesmanagement and salesmanship; but by that very token, as a technical expert in selling, I am all the more aware of the misuse and prostitution of the sound modern principles of creative selling such as developed by responsible corporations. It would appear as though the financial world had begun to adopt the high pressure system at the very time that it was becoming discredited in industry; and it, too, has now been taught its fallacy.

We are now ready to sum up the "new era" standards. Six have stood and four have fallen, and it is therefore demonstrated that we are, truly, in a new era, but not exactly the new era which in our fantastic eagerness we had pictured.

The "new era" now stands corrected in principle and precept, and the financial world, the business man and the average man or woman have no greater duty or opportunity than to adjust to it.

Recapitulating, the following "new era" standards have withstood the acid test:

One: the high wage, low price principle; the increase of the average man's purchasing power; as a basic industrial policy.

Two: the financial investment awakening of the average man, and his fundamental interest in investment-speculation; his widespread ownership of common stocks.

Three: the Federal Reserve machinery for check upon speculation, fluctuation and credit inflation.

Four: the higher stability and lower investment risk of the sound corporation, through modernized management and research principles.

Six: the principle that bonds are also partly speculative and in many respects inferior to common stocks as investments, for the average man, if invested in exclusively.

Seven: that investment and speculation are not two separate things in principle, but one and indivisible.

The above six "new era" standards have been preserved as sound, but the following four have been demonstrated wrong, and are wrecked:

Five: that a ratio of twenty or more times earnings is not almost always an inflated valuation for the most stocks.

Eight: that the market does not act in a unified manner, with general up and down swings, and that cycles of inflation and deflation are a delusion and no longer can occur.

Nine: that fiduciary institutions should carry most of their investments in the form of common stocks.

Ten: that the application of high pressure selling and promotion in finance is sound; and in particular that investment trusts cannot be oversold.

Chapter III

The Average Man's Criticism of His Financial Leaders

THE 1929 stock panic was a major catastrophe, despite the Babbitt-like efforts of some of our financial parrots to deny it and assure everybody that "business as usual" would prevail.

The "catastrophe" however was as great psychologically as economically; probably greater. Stung to the quick by the callous assumption of a large part of the financial world that a riotous, gambling and profit-mad public was responsible for tumbling down the huge house of speculation in the October-November 1929 panic, the average man is now ready to answer back. He is not interested merely in a bickering discussion of "who killed cock robin," but he sees in the situation a basic injustice and a serious menace

for the future. He is convinced that the financial world needs to shoulder a very large part of the blame; and he is frankly amazed and troubled at the fact that he now has a somewhat weakened confidence in the leaders of finance, who are shown to be almost as easily mislead as himself, and as inept at soundly interpreting the basic situation. This is the true catastrophe of the stock panic. The financial world does not seem to grasp how serious this is to the average man, who after reforming himself from his old-time trust in the fake stock promoter, and then pinning his faith in the super-wisdom of the financial world, now finds this faith badly shaken.

Lest such a point of view be regarded merely as one man's opinion, let it be stated flatly that those in the best position to know *agree* with the average man that it is undeserved slander to charge the stock panic to the public. Men of long experience in the financial field, like John Moody and H. Parker Willis, and shrewd financial journalists like Meryle Stanley Rukeyser and Louis Guenther, editor of the *Financial World,* are all of the opinion that the financial district must charge itself with the responsibility and not "pass the buck" to the public.

Bluntly speaking, a very considerable propor-

tion of the financial world has shown itself to be very poorly fitted for the role it wants to arrogate to itself, that of investment adviser to the average man. There is no question but that a large number of banking houses were hard at work urging more and more stocks upon the public to the very last day before the break, in spite of the fact that the financial district's own best analysts, and the Federal Reserve itself had warned that there existed a high peak of inflation and that a recession was due in the market. Such "babes in the woods" were some of these bankers that they even offered to exchange their holding company shares for well-known stocks, at the peak prices of that period. They were in the position of starting out on the sea in an open boat when all the official storm warnings were set against them. Not even an ignorant Labrador fisherman will do this.

But we have only begun with our criticisms. Very questionable jugglery of assets and earnings in corporation reports and statements has occurred, even among some quite "respectable" corporations, in the desire to "re-finance" or merge, and thus add to the huge tidal wave of stocks issued. It is significant that the public accountants discussed the ethics of their profession at their last convention, and girded their armor

against the pressure brought upon them to "innocently" juggle the figures in order to "doll up" a corporation's accounts so that they might enthuse and entice investors. Padding balance sheets and income accounts is obviously fraudulent, but there is much that is akin to it, merely in what is *left out* of statements. In spite of the fact that the New York Stock Exchange has the highest known requirements as to information, I would estimate that a third of the corporations listed even there do not make what I would call *fully adequate statements;* some not giving sales volume at all and others not issuing any but yearly reports instead of quarterly reports, as they should. Naturally the situation on the Curb Exchange for a great many corporations is much worse. It is the mistaken idea of many of these corporation heads, who are entirely honest men, that the less the public and competitors know about their business the better; also that when conditions are not positively roseate they can be hidden by keeping silent. This point of view belongs to the "mauve decade," and is not worthy of modern business; certainly not business which has or desires a large number of stockholders. In particular it is the worst possible incentive to stock market gyrations. You can imagine *anything* about a corporation which

is hiding its earnings or true statement. There are corporations which do their best,—like old misers who tuck their fortunes under the mattress and in old tea cups—to hide their large surplus wealth by bookkeeping ingenuity; and of course the other kind which try to make their assets "look like a million dollars." Neither of these extremes is fair and honest treatment of stockholders, who are so numerous today that the average man is entitled to more serious consideration. The stock market is entitled to more freedom from "black magic," whispering campaigns and old wives' tales. "Mystery markets" make for panic—and also encourage tipsters in their work. The obvious modern method is very *full and complete data.* The average investor-speculator, after this stock panic, is more than ever determined to get it.

A still more serious accusation, which also lays the blame upon the banking world rather than upon the public for the stock crash, is that half the money obtained from the sale of "rights" by many corporations was used, not in the development of the business, as the stockholders supposed, but in lending to Wall Street for speculation purposes at high call money rates. The accusation is sponsored by H. Parker Willis, editor of the New York *Journal of Com-*

*merce.** It is one of the most damaging indictments of corporation and banking policy made in a long time. Many small investors were wiped out because they had spent considerable of their liquid capital buying additional stock with the "rights" given them by corporations, and the stock thus purchased declined greatly even before the stock was delivered or fully paid for. Meanwhile the funds thus obtained had been used against the subscriber's interest in adding to the speculative *debacle!* It would be easy also to prove that building activity and business in general were to a moderate degree restricted by the diversion of credit from regular channels to Wall Street speculation.

Dr. Willis makes the flat accusation also that the market had been flooded before the "break" with "perfectly worthless issues." (Most of them not listed on the exchanges.) These he says "were punctured like cheap balloons" when the break came. He, like John Moody, is undoubtedly referring to the flood of investment trust issues, especially the holding and trading ones; and naturally the banking world must bear the heavy load of this responsibility, for they

* See leading editorial, *New York Journal of Commerce*, Nov. 4, 1929.

were sponsored very markedly by banks and bankers.

The banking world has also been guilty of other indiscretions, in which the average investor-speculator was the victim and not the culprit. Concerns affiliated with banks—investment trusts of various kinds—bought heavily of common stocks, and thus were strong influences in "bulling" price levels upward, and then sold these investment trust shares to the average man as "investments," with all the conservative flavor of bank-sponsored solidity. They were not and could not, as a matter of fact, be regarded as "investments." They were investment-speculations, with very considerable emphasis on speculation, because of the concerted bidding up which the investment trust buying had accomplished in the market. Far better if the average man had bought his own common stocks, after his own analysis. In this way he was precisely in the familiar position of the buyer of aggressively promoted suburban lots who pays a price per lot which includes all the high cost of promotion and the discounting of its future value for years to come. In other words he is the same old "sucker" in a new guise, but *this* time the man who sold him is not a fake stock salesman or a real estate "slicker," but a responsible banker.

And let me add, for justice's sake, that such bankers have been quite innocent of wrong intent; quite as J. P. Morgan the elder was innocent in the New Haven Railway mess, in which widows and school teachers lost their savings. These bankers have simply registered *their own limited competence.* Once more they are proved to be quite as prone to error as any other group, and by no means as omniscient in their judgment as they have wished the general public to believe. The old picture of the banker as a pundit wise, cautious, conservative and carefully analytical is certainly now ready for the discard. *The average man must trust himself more, and make himself more trustworthy in finance.*

This point I wish to emphasize and push home with the utmost earnestness, for it is at the very heart of my contention that the average man must be urged to do more thinking for himself about investments. It is a good omen, and certainly not a bad one, when the average man himself wishes to share the responsibility for his investments and not follow blindly the old notion that a banker knows everything and should decide everything. Even in other and more vital matters, of life and death, this doctrine is now antiquated. Dr. Joseph Collins, famous author-physician, has gone on record in *Harper's Maga-*

sine as of the opinion that the average man must develop his own sense of responsibility in regard to medical matters; that doctors, even good ones, sometimes mislead and make grave errors, and should be "fired" and a new one engaged, and their judgments subjected to the average man's analysis and independent thinking. The amount of competent "self-medication" today is enormous. The average man today knows more about medicine than the average doctor did 50 years ago. We are a hygienically "literate" people, and the best physicians are strongly encouraging the tendency, even now paying for an advertising campaign to boost it. The more the public knows about medicine and health the better for both doctors and public.

In the same way the average American is greatly increasing his interest in and knowledge of finance and business. He finds his investments of such very great interest and importance that he cannot *and will not* turn them over entirely to specialists unless he is markedly inept at business and has not taste for such matters. America is a business country, of millions of men and women trained to independence and to self-help. These people find part of their interest in life, even part of their thrill in life, in the use of their faculties in putting their money to work. They

are at this moment in American history at the point of dropping sheer *speculation* as an interest and thrill, and substituting *investment-speculation,* which is the sound and true American policy for all those with surplus above $2,500 or thereabout. It is a serious set-back, and a demerit to American financial leadership that this new development on the part of the public—even to any extent, and even if without evil intent—has been given a set-back by the incompetent and greedy leadership of some of our financial "leaders," who should have been disciplined before they wreaked such damage. At the same time, the conviction is only driven deeper into the average man that he must trust his own judgment more and the "barkers" for stocks less, even if those "barkers" are in fair repute in the financial world. He can never be held in the financial "peasant" class of a buyer of bonds only, and even if he could be, he is now acquainted with the fact that this would still be investment-speculation rather than investment only. He cannot be stopped from his determination to be on a par with the moneyed men of America in common stock ownership; nor should he be stopped.

Henceforth, the financial world would do well to turn its attention to far greater service and

accuracy and conservatism than ever in guiding the sane and logical investment-speculation desires of the average man. It should follow the policies of our great business corporations which have built such great good-will by splendid, progressive service to consumers, and provide much better machinery for the average man and his well-informed security purchasing. *The stock market of the future belongs to the average man; it is his by right of the new revolution in universal ownership of American industry.* For this very reason the stock markets must be made safer and more serviceable for the average man. The securities sold in this market should be still further beyond suspicion; the information available about them still more detailed and prompt, and the manipulation of them made still more difficult, if not impossible.

It is ominous that the public's appointed master of finance, the Federal Reserve Board, has been vindicated as more wise than many of the reputed financial leaders who fumed at it and wanted it to function for their benefit, rather than for the benefit of the average man. The policy of the Board, months before the break, of discouraging borrowing by member banks for speculative purposes, was stiffly criticized, and one well-known banker made a defiant gesture

in contradiction of it. But that same banker, let it be noted, was one of the sober six who gathered in Morgan's office on our modern "Black Friday" and tried to gather up the broken pieces, thanking fortune and the Federal Reserve for the fact that the criticized policy had resulted in call funds being available at between five and six per cent, and the New York Reserve member banks in the strongest and most liquid position known in a great many months. There can be no gainsaying the fact that had the financial community been left to its own devices, and had the Federal Reserve Board not held firmly against its critics, a situation of the most calamitous kind would have developed, from which the country might not have recovered for years. As it is, the damage is immense.

The Reserve Board,—the public's representatives, the average man's own watch dogs over the average man's interests,—has come out of this stock panic with real laurels, while certain elements in the financial field have reason to hang their heads in embarrassment, if not in shame. The prestige of the Reserve Board is now very high and there should never again occur a "high-hatting" of the Board, or incipient rebellion among certain groups who have a conviction that they alone are financial wiseacres.

It is easy to see why in years past the public developed a bitter hatred of "Wall Street." It had no means of stopping or curbing its arrogant and incompetent gyrations which weakened business and cost the country periodically a very pretty penny. They were due to precisely the same over-greedy and superficial, pyramiding operations which operated in 1929. That, thanks to the insistence of the Reserve Board, there was a cushion of credit on which the market could fall, *is a salvation which the average man worked out for the country,* and not the financial world.

There are plenty of able, trustworthy bankers in the financial field, and there is certainly no reason to lose confidence in all bankers. But there is genuine reason for protest that the able leaders did not guide more surely the average man's fortunes, nor restrain the groups in the financial world who were undermining the situation by practices squaring not at all with well-known sound principles; some of them not even with honest fiduciary standards of morals and responsibility. There was a definite lack of that firm leadership and conservatism which it has been traditional for centuries that bankers display. I do not believe that ever again will the average man give quite as much credence to

what financial leaders say. Possibly it was unfair ever to have invested them with the infallibility we did. Few men indeed are economic seers.

Just as the retailers of the country, after the 1920-21 upset, when they held too heavy stocks of goods, acquired because they had been wrongly advised, resolved to adopt the "hand-to-mouth" buying policy and definitely listen less to the slick salesmen calling on them;—so the average man of today is resolved to show greater independence of his own in regard to investments, and be thoroughly skeptical of brokers, tipsters and bankers with top-heavy "investment" trusts which were in reality *speculation trusts,* as well as of others of the financial field with a lot of stocks to sell and refinancing and consolidation axes to grind. He now realizes that in jumping out of the fake stock frying-pan, he jumped into the Wall Street over-promotion fire. To what extent, he realizes when he sees that as against only 296 millions of new stock issues put out in 1921, there were 3 billions (ten times more) issued in 1928, and as much more in only six months of 1929. Unchecked, 1929 would have *doubled* the huge 1928 total! This is nothing else but an impossible deluge, carrying on its very face the repudiation of reason and cau-

tion. The fact that in spite of these technical signals of inflation financial leaders in large proportion held onto and encouraged boom psychology, is now burning into the average man's consciousness, and he does not take kindly to the talk about "the public's wild speculative orgy." Even the average man knows that he is *a follower* and not a leader, and that if he over-bought, it was because he was concertedly, vigorously urged to do so by the recognized financial world of leaders.

Financial men themselves are demanding an end to excessive speculation on credit. President Michael H. Cahill of the Plaza Trust Co., New York, advocated before the Economic Club that all banks agree to lend no more than 75% on securities, on a valuation no greater than 20 times earnings. If bankers won't agree, Congress should compel, he insists.

In my opinion the situation is in general, good prophylaxis. Our American enthusiasm, always straining toward extremes, needs checks and balances, but is slowly seeking a good center. Let the average man now be served with genuine competence and care, participating in common stock ownership, and we will have a "new era" that is fully worthy of the name.

Chapter IV

How Has the Stock Panic Remodeled the Standards of Stock Valuation?

AS a great business man once said, "The making of mistakes is inevitable, but *learning* from mistakes is the vitally important thing that marks the able man from the stupid man."

The very heart of the lesson of the stock panic —for both the average man and many financial men—is, what have we to learn from it as to the wisest standard of valuing stocks? We had set up very definite measures on this matter. Inside of twenty or twenty-five years we had stepped up, in four stages of growth, the measure of stock valuation from an earnings-to-price ratio of 5, to a ratio of 20, in jumps of 5 points. It rose almost at the rate of a point a year; and in the last year or two began to go even higher, as the "new era" doctrine went to people's heads.

There were stocks priced during 1929 at ratios of as high as 30, 40 and even 60!

The ratio of earnings to market price is naturally a tremendously searching and important one. It goes to the very heart of the matter from the investor-speculator's point of view. It is one of the most useful, and at the same time most simple and easily calculable tools which the average man or woman can use to check his judgment and his information about a stock. For this reason, a clear and sufficient study of it will be very helpful, looking back over a period of years to see how it has worked out.

Many years ago it was the practice to carry the item of "good-will" on the books of companies, often at huge figures. A good deal of the criticism of business came from this practice. The public had the same reaction to a corporation which said its good-will was worth $50,000,000 as it had to an individual who loudly proclaimed that he was a very virtuous and valuable person. The public didn't like it, and sneered at this good-will as just plain "water." That is how the old phrase "watered stocks" originated.* The

* By the way, this phrase "watered stock" was coined by that picturesque old Wall Street pirate Daniel Drew, who had been a cattle drover, and who knew the crooked practice of filling the cattle up with water just before they were put on the scales to weigh.

average man would far rather set his own valuation on men and corporations. In fact, he insists upon it! The average American man is nobody's fool and he does much thinking for himself, and is very free with his opinions!

Particularly during the era before the no-par value share was extensively used, accountants felt that a balancing figure representing all genuine value should be listed among a corporation's assets. It was a technicality, but it was not popular. Corporations since the war have very generally dropped it, particularly corporation's whose shares are listed on stock exchanges. As the head of one corporation has said, "I much prefer to leave it to the stock market to settle what the good-will of my company is worth." On the stock market it is the public and not the corporation which sets the value of good-will. *That* is what has brought about the difficulty! The public—aided and abetted by economists and financial men who should not have been so unsound,—grew more and more bold in its ideas of good-will valuation.

All the New Era Standards, One, Two, Three and Four created the favorable atmosphere for this—and now we have seen the axe of natural law fall upon it and trim it.

It is worth while to recount a graded series

of steps up which we traveled in our ideas of valuation of a corporation:

One: There was no need for valuing a company publicly, in earlier business days, when there were few shareholders and businesses were usually sold by individuals to individuals. Under such conditions the buyer paid whatever arbitrary price appealed to the owner. There was virtually *no* standard. *"Caveat emptor"* ("let the buyer beware") ruled supreme.

Two: When business life became more organized, then we had to have some common consensus of opinion; some rule of measurement. The courts themselves were obliged to set up some fair standard, in order to settle estates and disputes. The author, twenty years ago qualified in court as an expert on good-will valuation, and recalls that he testified under oath that it was the general trade conception of valuation of a business that five times the five-year average of earnings was a conservative standard. But even at that time, and before, higher standards were known and recognized, although six times was occasionally set by the courts, and on rare occasions more. Thus a Surrogate Court accepted as fair a ratio of 10 for the 60-year old business of Tiffany & Co. the famous jewelry business. In the case of the New York *World*

a ratio of 10 was also admitted as fair. In both these cases the good-will element was obviously very high, and the tangible assets far below the sum of valuation. These corporations were very widely and favorably known to the public; far more so, at the time, than most industrial corporations.

Three: When the large corporations—beginning about 25 years ago—began to advertise widely to the public, the good-will factor began an ascending career of valuation which was not realized until after the war, when corporations began to consolidate and change hands more frequently. Very high prices were paid for good-will (as for instance 13 millions for "Castoria," with but insignificant tangible assets). It slowly began to dawn on bankers and shrewd investors that companies which were favorably known to the public were in possession of a value, however intangible, which could be reflected in dollars and cents both on the stock market and in valuation for inclusion in mergers. "Book value" (assets carried on the company's books, such as plant, inventory, machinery, etc.) appear to have far less certainty of value under modern conditions of rapid change, and to possess much less attractiveness of value than simply the "going value" or good-will of the business. Plants, ma-

chinery and stocks in hand, in these days of speedy obsolescence, are actually something of a liability rather than an asset. It is a fact admitted by the Government experts that about 45% of American factory equipment is obsolete. Certainly 55% of industrial plants and 50% of office equipment is obsolete. The meat packers today, for instance, find themselves faced with need for an alteration and modernization of equipment (for the new freezing process) which will run into quite enormous figures. Scores of other industries are in the same position. Their "tangible assets" (which once were regarded as their total net worth) *are now far less valuable than their good-will.* The president of Montgomery Ward & Co. in 1918 told his stockholders that he had no doubt whatever *that the company's good-will was more valuable than the company's entire tangible assets.* Subsequent stock market rises fully justified this statement. Some perfectly astounding further examples of this are possible to cite. When the Gem Safety Razor business was bought for $4,000,000, $3,000,000 of this sum was for good-will only. When George K. Morrow bought the "Bixby" "Shinola" and "Two-in-One" he paid $8,300,000, of which just about one-half was for good-will only. When the Dodge Bros. Co. was sold, Dillon, Read &

Co. paid 56 millions above the appraised valuation of 90 millions, or a good-will price of 74 millions, which alone was 8 times the five-year average of earnings. The total price was a 16 ratio of five-year average earnings to price paid. At the time this ratio was higher than J. P. Morgan & Co. or General Motors would bid, and was regarded as an excessive ratio.

Another astounding example was the purchase by the General Foods Co. of the Maxwell House Coffee business which was purchased for 43 millions, 41 millions of which was sheer good-will price. This was a 15 ratio to current earnings; and although this ratio did not set a record, the great preponderance of good-will in the price was more startling than any previous example.

Here we see how valuations have in recent years been put upon companies by purchasers and by the investing public, which were far larger than any which any company in the past had of its own accord included as good-will in its balance sheet. Even the highest of such self-valuations (57 millions by the Goodrich Co.; 54 millions by the American Tobacco Co. and 50 millions by Woolworth in years past) have been surpassed by the valuations placed on these companies *by the public*—even after the severest stock price breaks.

Here we see, then, *three distinct steps* toward new standards of stock valuation, each with a characteristic ratio of earnings to price. First, a ratio of 5; second, a ratio of 10, and then a ratio of 15; all within a period of 25 years of time. *If the development had stopped just there, we should not have experienced the stock panic.* The fact is that the momentum of the entirely *legitimate* "new era" was now so strong that the well-known American temperament of excessive enthusiasm and optimism began to boil up the pot until it just had to *boil over.* It was carried past the legitimate goal-post on out into the bog of utter inflation, even illegitimacy. The 15 ratio was seized and ridden upon the shoulders of financial ballyhoo and rainbow psychology, in the fashion of callow college boys at a football game, until it was pushed on over the 20 line, and nobody knew where it would next be pushed.

In 1924 the combined net earnings of six large good-will food companies (Beechnut, Corn Products, Coco Cola, Fleischmann, National Biscuit and Postum) was 45 millions, and the combined market value of the stocks 491 millions; which is a ratio of about 11. By 1927 the ratio had increased to over 16. In 1924 seven automobile companies* had combined earnings of 87

* General Motors, Studebaker, Packard, Chrysler, Hudson, Willys, Nash.

millions and the combined stock valuation of 702 millions; which is the ratio of only 8. But by 1927 this ratio had risen to over 14. Taking another group, the tobaccos (American, Reynolds, Liggett & Myers and Lorillard), the 1924 earnings were 61 millions, and the stock market valuation 653 millions. This was already a ratio of 10; but by 1927 it had risen to 17.

Practically all of these markedly "good-will" stocks,—each spending millions of dollars in advertising, and the total 17 companies considerably more than doubling their combined earnings in 8 years,—experienced a still higher increase in their ratios during 1928 and 1929. Some went over the 20 line and others were more conservative; but they were all the special objects of enthusiasm.

The change since 1924 is surely radical. In 1924 the "book asset value" (that is, the *tangible* assets) of General Motors, Packard, Studebaker and other motor companies was *greater* than the market value of the stock. The same was true of many other companies, although the tobaccos have always had a very high good-will valuation. In fact it is entirely an error to say that all companies were conservatively valued years ago. The food group which I have listed above were, even in 1924, selling at about twice their "book

assets," and the same was true even of such famous companies as Eastman Kodak or Gold Dust.

Now when we come down to the high-peak period just before the stock panic, what do we find?

We see that based on 1928 earnings, 400 common stocks in the industrial field show this record:*

			Per Cent
Under 10	times	earnings	10.7
10 to 12	"	"	9.6
12 to 15	"	"	18.8
15 to 20	"	"	20.0
20 to 25	"	"	12.7
25 to 30	"	"	8.8
40 to 50	"	"	1.1
30 to 40	"	"	3.8
Over 50	"	"	4.1
Earned nothing on common			10.4
Total			100.0

Thus we see that at the close of 1928, 83.3% of representative common stocks were selling over ten times earnings.

79.7% were selling at over twelve times earnings. 60.9% were selling at over 15 times their earnings, and 40.9% were actually selling at over

* Compiled by Poor's Manuals.

twenty times their earnings! This, then, is the extent to which the "orgy" of inflated stock valuation went before the stock panic (although not the *fullest* extent, for, during a part of 1929 these ratios undoubtedly went considerably higher). It would be safe to say that, at the peak of the upward trend in valuation *one-half* of these stocks were valued at a ratio of 20.

But right here we must pause to remember that this calculation is based on a large list—400 common stocks. A *smaller* group had actually a higher ratio, while the *entire* group of more than 400 had a *lower* ratio. For instance a group of 10 industrials had the following ratios, based on 1928 earnings:

	Price	Price Earnings Ratio
Allis-Chalmers	$270	23.9
American Can	158	23.0
Atlantic Refining	77	10.0
Fleischmann Co.	89	20.3
General Motors	76	12.6
Liggett & Myers "B"	90	13.2
Montgomery Ward	117	24.5
Paramount-Famous-Lasky	65	16.1
U. S. Steel	201	16.1
Woolworth	91	25.1
Average	$123.4	18.2

Here we see individual instances which even

on a 1928 calculation, reached as high as a 25 ratio. These ratios increased during 1929, some of them to a 30 or 35 ratio.

In August 1929, the high peak, *all* common stocks, as per Standard Statistics Corporation, were selling at a ratio of only 13, and this was actually a reduction in ratio from 1928, when it was 14. This seems like a paradox, but it is explainable on the basis that a great many stocks actually declined and the large increases were in a relatively few stocks. The true picture is, then, that the extravagant ratios of valuation were applied to certain *selected stocks,* while many others were actually under-valued, even according to the most conservative ratios. The ratio average for all the ten selected stocks listed above was 18.4, whereas ten typical railway stocks were valued at an average ratio of only 13. Thus the railways, and the motors did not share in the rise, and the whole movement was very uneven and unintelligent, without any consistent scale of valuation. Stocks which were already selling at a valuation ratio of 25 were bid up still further, while those which were selling at a ratio of 13 were bid down. *There was lacking even a fundamental understanding of the meaning of such a ratio;* and this is what I shall discuss in the next chapter.

Is there any wonder that our ideas of methods of stock valuation become rather confused and arbitrary when we examine what the drastic October 1929 stock panic did to the earnings-to-price ratios? Even in the public utility field, which had been hit the hardest, there were still very high ratios left among some of the soundest stocks. Thus Public Service of N. J. was selling at a 26 ratio (using estimated 1929 earnings for calculations), Consolidated Gas of N. Y. was selling at 22 ratio, Commonwealth Edison of Chicago at 21, Amer. Tel & Tel and Consolidated Gas of Baltimore at 19. Even in the railway field, which has consistently held to an average ratio of 10 as against 18 for industrials, there were same high ratios—Canadian Pacific, for instance, 17. Illinois Central was at 13, Delaware and Hudson at 12.

Among the good industrials we still had a number at a ratio over 20, such as National Biscuit, Aluminum Co., General Electric, U. S. Freight. We had American Can and Foundry at 29, American Tobacco B at 17, and many at 17 and 18 such as Woolworth, Allied Chemical, Otis Elevator, Corn Products, International Nickel, International Business Machines, American Bank Note. Some of these have had their ratios clipped since.

These stocks unquestionably were regarded as having very lively possibilities for future growth, whose ratio was not pared down even in our most hectic panic. If we are to learn something from events, it is necessary to conclude that our more alert and favorably situated corporations have prospects which in our worst moments we cannot forget. A ratio of 15 to 20 may be said to be merited occasionally by companies with unusual prospects, if they are genuine prospects, near to realization.

The stock panic shook *twelve billions of dollars* out of the valuations of only 240 leading stocks on the New York Stock Exchange, in the September and October 1929 stock drops. Doubtless a total of 30 to 40 billions, at least, was shaken out of the peak valuations of stocks in general during October-November 1929, although a part of this loss has been regained. According to the Fisher calculation of the high point in September 1929, 215 of the most important Stock Exchange Stocks registered then an index figure of 209, which in the October 1929 stock panic dropped to 182, and a little lower later. This represents a 14.8% to 20% decline, and this gives me warrant to estimate that the ratios have been pushed back in the neighborhood of 5 points, so that *we are now no longer in the*

era of a predominating ratio of 20, but of a ratio of 15 or less. It becomes a question of whether we will become more intelligent as to this matter of the ratio of earnings to price and thus keep our feet upon the ground hereafter.

Chapter V

What Is a Fair and Sound Ratio for Stock Valuation?

DOES anybody know what is a sound and fair valuation of a common stock? Is there any ratio of earnings to market price which may be said to represent a logical standard of measurement? This is a perfectly fair, and for the guidance of the average man, a rather necessary piece of information. Surely the gyrating stock market, and the general changes in ideas on this subject make it quite particularly advisable at this time to set up some recognizably sound ratio.

In such a matter it is logical to consult the highest economists. Prof. Irving Fisher, of Yale University, is not only a noted economist, but also a man of reputation in matters of finance. Surely he should be able to throw real

light on the subject. He believes that a ratio of about 12 is sound. Nowhere is there any criticism of this ratio as unsound, and it has, so far as any analysis can test it, not the slightest flaw. It is distinctly conservative, taking all modern conditions into account. It is true that others slightly more conservative, like Louis Guenther, editor of the *Financial World,* cling to a ratio of 10. An average would be 11. In my book on mergers * I laid down a definite principle by which good-will might be measured: "If a company is so established and so consistently prosperous that it produces earnings beyond the normal average profit for its field, it is proper to capitalize good-will at that sum upon which such excess profits will pay current rates of interest." This rule is a good guide in judging the market price of a common stock, since nowadays not the company but the investor sets the valuation of good-will, in the market price.

It must be remembered that the ratio of earnings to price refers not only to dividends paid, but to *undistributed earnings,* and that the subject is thus complicated in the case of some stocks by the fact that not only have some companies a large undistributed surplus, but that this sur-

* "Modern Industrial Consolidation," J. George Frederick, The Business Bourse, New York.

plus is so carefully invested that it is earning a very good return.

This factor normally shows itself in the earnings, but one other factor does not. Nowadays, many of our corporations have worked out new affiliations and mergers in such a way that they have, or are about to have, new sources of earnings, often very large. The Am. Tel. and Tel. with its Western Electric affiliation; the Standard Oil of N. J. with its new chemical developments; the General Foods Corporation with its new food freezing affiliations, and various others, are in reality worth more than the normal ratio of 11 or 12, because of their definite *earnings prospects.* Earnings prospects of a very specific kind *justify the enlargement of the normal ratio.* But this is always a thoroughly speculative thing to do, because of the proverbial "slip betwixt cup and lip." It is, for some stocks, quite as sound a *speculative* procedure to increase the ratio as it is to be willing to buy at 80 a stock at present paying no dividends, which, however, there is reasonably good information will declare a 6% dividend at the next meeting. All non-dividend paying, deficit showing, or small-earning common stocks, of which there are many, are sold now, as a matter of fact, on a basis quite beyond the ratio of 12. There are no multiples of zero! A

company which for several years has shown little or no earnings, but whose stock is quoted at a market price of 22, let us say (there are scores, if not hundreds such) might be said to be selling, at the very least, at a ratio of 22, although we might as well say the ratio is 2200, for all the mathematical accuracy in such a figure! The point I wish to make is that the factor of *earning prospects* is the driving force behind ratios, and that this driving force has no top nor bottom in strict logic, since earning prospects do not easily submit themselves to measure. We can never forget, in considering common stocks, that a share of it is a share in all future prospects of earnings, whatever they may be and that if these, in all truth are going to be very large, then the stock is certainly entitled to a high ratio. Nevertheless there is always that deadly "if," which so tantalizes the investor. Quite reasonably, because of genuine "new era" factors I have named, the expectation of profit in many common stocks has been increased, and this has made reasonable the ratio of 12, which is also my own choice of a logical ratio for general average use.

This ratio of 12 cannot, for the reasons I have just pointed out, be an arbitrary and inflexible one; but it is the North Star by which to steer;

the "gold basis," so to speak upon which to base calculations; a *point of reference,* in other words.

The serious error made by the undiscriminating public and financial world during the boom was to take the high ratio which was perfectly fair for some *selected* stocks, particularly those with undistributed earnings and investments and with exceptional prospects of new earnings from new sources—and apply this ratio to more and more other stocks, until the maximum ratio was being applied to stocks which did not warrant it. Some intuitive warning of the unsoundness of this started the stampede.

Now, the real crux of this matter of a fair and sound ratio of earnings to price is not only what constitutes a reasonable figure, but how are the future good prospects of stocks to be judged in terms of a ratio? In other words, just what is the average man to think about a stock having exceptional prospects which are not now showing in its earnings? Is he to ignore the factor of prospects and use only the present earnings-to-price ratio, or is it to any degree sound to let those exceptional prospects push up the ratio which he is willing to pay? Should he pass by a stock with a ratio of 16, when there are definite prospects that the stock will be earning a great deal more than it is now? Nothing could possibly

be more important to the average man than a sound answer to this, for it was precisely a lack of wisdom on this point that made the stock panic.

First let us examine the position of those who insist that the 12 ratio is a good general guide, but that some stocks may deserve higher ratio. Prof. Irving Fisher himself is one of the chief exponents of this view. "It is the common stock that gets practically all the benefit from increased earnings," Prof. Fisher urges us to remember.

"If today a corporation earns $1,000,000 a year for its common stockholders after an equal amount or $1,000,000, has gone to bondholders and preferred stockholders, it is clear that a doubling of this total distribution among all investors from $2,000,000 to $4,000,000 will leave $3,000,000 for common stock, which is not simply double, but triple, the previous earnings of the common, which were only $1,000,000."

In other words, he makes clear that if a stock is going to earn three times what it earned before, it is certainly entitled to a valuation in keeping with this. He says, further, that it is not alone prospect of more *earnings* that may logically give a stock a higher price, but if it can be said that there is *less risk* that the earnings will drop, then a higher ratio is also permissable. I should

like to add that the *scarcity* of a stock (the amount of shares available for trading) is also a factor in giving a stock an advantage in valuation. Fifty to 75 such stocks, before the crash, sold at prices 25 to *as high as 60* times earnings, and some of these stocks paid no dividends at all! The yield on some others was as low as 1% or less!

This is precisely the difficulty with increasing the ratio of earnings to price; *where shall one stop?* If you start the process upward, what guiding measure is there? None! In such a situation, one must make arbitrary rules for oneself, even though one cannot claim that they are scientific. One can make such rules o'thumb as this:

(1) *"I will under no circumstances buy a stock which is selling at more than 12 times earnings."* This will be keeping well away from the zone of danger; but of course there is also some danger even within the ratio of 12.

(2) *"I will under no circumstances buy a stock which is selling at more than 12 times earnings, unless there are large amounts of undivided earnings or surplus, and then I will go as high as 15."* This will make it possible to include some very good stocks which have been "plowing back" into the business or accumulating earnings. But even

these should not be chosen unless they have very unusual prospects.

(3) *"I will under no circumstances buy a stock which is selling at more than 15 times earnings, unless I have very precise and definite knowledge of large coming earning power or increased dividends, which has not already been capitalized or discounted, and then I will not go higher than a ratio of 20."* Here is where I believe the average man or woman should positively stop. One can grant that there are instances of stock which warrants a higher ratio under the special circumstances, but they had better not be touched by the average man or woman.

Here is a selective trio of policies from among which the investor-speculator can choose, according to his temperament, but mainly according to the size of his capital. For a man with less than $10,000 to invest I recommend that he stick to Policy Number One. Policy Number Three should only be for the man with $25,000 or more capital, and considerable business experience.

It is a curious fact that, owing to the change in psychology from a boom market to a depression market, the standards of value, even among the coolest and most analytical minds, changes. In boom times, even cautious, experienced financial men will regard a ratio of 15 as not excessive for

a certain stock, whereas in depression times a ratio of 10 will be considered excessive, *for the same stock,* no matter even if the company's earnings prospects are brighter in the depression period than they were in the boom period! This is the paradox of our economic life. U. S. Steel was selling, at its low point during the panic, at a ratio of only 8 times earnings. Other good stocks were down as low as 5 times earnings. These same stocks will surely sell again at 12 to 15 times earnings. Indeed, just because attention was not fixed on them and they were not "pilot" stocks, other stocks were selling at a very high ratio at the same time that the "pilot" stocks were selling at a low ratio. The chain store field, for instance, was selling at an average of 11.8 times earnings, with Childs at a ratio of 18.3, Grant at a ratio of 15.4 and Penney at a ratio of 16.4. Meanwhile the railways, which even before the panic had been selling at an average ratio of 10 was selling at a ratio of about 8, with Rock Island down to 7.

All these ratios are below the 12 ratio which I believe is a sound average, and this is how the bargain nature of the present panic market,—likely to continue during all of 1930—is proved. Many of the stocks in these groups deserve a ratio higher than this average, because of their large surpluses.

Chapter VI

Lest We Forget Our Common Stock Net Gains

IT is perfectly natural, after the most mad toboggan slide of stock values known to financial history, that we should be dizzy and a bit pessimistic.

A little of the calm, cool philosophy of relativity will be a valuable antidote. It is only because stock values so rapidly moved to such a record high point that the rapid decline seemed a catastrophe. Actually, over a point of view of *years,* not months, we are still in a very unusual position of *gain.* There is still enough net gain left to make the record over the years a very good one, even a *remarkably* good one! It would be silly to lament that whereas yesterday we were so flush that we ate *five* meals a day, we are today reducing to just *three!* Big drops

of value are depressing only after we calculate the *net* gain or loss over an appropriate period of time. The truth of the matter is that we have been flung about on a mad Coney Island whirligig of values, and after "shooting the chutes" at 90 miles an hour, the very good speed of 40 miles an hour naturally appears tame.

The rises in values in recent years have been nothing less than El Dorado dreams of fortune, and Alladin-like rubbings of the magic lamp. To read the story now is to realize this to the full—but even so there is enough remarkable good fortune left, after the rude awakening of October-November 1929, to keep some of our wonder and satisfaction. Let us play with this sense of magic and wonder for a moment.

George F. Baker, one of the three or four richest men in the world, in one day during 1929 made more profit from just one of his stocks (U. S. Steel) than ever was made by all the prospectors combined in five years out of the great Klondike gold rush! Imagine all the labor, the hardship, the time, the money, the crime, the heartaches and failures, loss of life, the suffering, the waste which went into the exciting period of the search for Klondike gold. Yet one day between breakfast and dinner time a man, who wasn't even giving any attention to the matter

made more than twice as much gold as all those eager "sourdough" prospectors did in a total of 1,825 days of effort and dangerous adventure! *And then on another day in 1929 he lost an amount even greater, all in one day!*

The general facts about finance are quite as remarkable as any merely true tale of the fortunes of wealthy men. For instance, the number of shares listed on the New York Stock Exchange has increased 50% in four years. The rise in values of these listed shares during 1928 totaled 18%; 21% in 1927, nothing in 1926 and 12% in 1925. The rise between 1925 and 1928 reached the startling percentage of 66%.* In other words, the man who, let us say, owned one share of every stock listed on the New York Stock Exchange in 1925, valued, let us say, at a total of one million dollars, and who simply put them away in his safe for three years, found himself worth $1,666,666 on December 31, 1928. Scale this down, and say that a theoretical man on December 31, 1925 had $10,000 worth of average New York Stock Exchange shares. This man, without any effort on his part would have found that his stocks were worth $16,666 on

* These figures come from President Simmons of the New York Stock Exchange and are official. They are "weighted" according to the outstanding number of shares of each issue listed and are thus accurate.

December 31, 1928. Each dollar had become $1.66. This, bear in mind, is exclusive of any cash or stock dividends he secured during this period.

Now what did the terrible, devastating, cruel and shocking 1929 panic do to this theoretical man? How did this gain come out in the "test by fire?" First, we must calculate what further gain was made during 1929, up to September, when the high point was reached. We find that the percentage gain was 22%. Our theoretical man's dollar investment would have reached $2.03 by September 1929.

And then came the deluge—with a drop (which I estimate in late November 1929, after the full series of major declines had taken place), of 28%. Our theoretical man's dollar investment was then reduced—alas and alack!—to $1.46. In other words the $10,000 which he invested on December, 1925 in average New York Stock Exchange stocks would now, about four years later, have become $14,600; a 46% gain—net, after the panic did its worst! He would, besides, have had all the dividends, stock split advantage, etc. What a perfectly dreadful showing!

It takes a calculation like this to awaken us to a correct perspective and to keep us from our

usual vice of superficial thinking. Quite particularly, it makes clear the superior position of the true investor-speculator, *who bought outright several years ago and held on to his purchases.* True, he would have been wise to have sold out in September; but on the principle of *holding* he will not have gone wrong, even if we calculate from the present "bottom" of the market. Just for fun, let us see what he would have gained had he sold out in September. He would have sold his $10,000 for $20,300; "doubled his money" as the saying goes, in four years. But since no man can be expected to be so wise as to sell out at the top, look then only at the net, at *low* prices. He is still very nicely indeed ahead by $4,600, thus proving by actual "fire test" that the doctrine of investment-speculation, solely for the purpose of "growing with the country," is sound, and sound *for the average man* who keeps away from the ticker and margin calls.

I have spoken elsewhere of "the tide" of forward-moving values in America, and the above example illustrates it perfectly, even after one makes a nautical calculation of "correction of position," allowing for a contrary tidal drift or hurricane head-wind. The net gain, or forward progress despite opposing pulls, is real and definite; 46% in four years of time, or an average

of over 11% per year. If that is not a sufficiently El Dorado-like development, then surely our appetites have been perverted by our banquet upon the peacock's tongues of super-boom-times!

This average man of whom we speak, with $10,000 in 1925, could quite logically have been an average man with an earning capacity of let us say $4,600 a year, and if this were so, it might be said that his investment presented him a kind of "sabbatical year" gift every four years *of a full year's salary.* If this is not thoroughly "debunked" magic, but magic still, then I do not know what magic is and have lost my sense of wonder and appreciation. This average man—to continue relentlessly, but with our eyes open, with this calculation—might then work toward accumulation of four more blocks of $10,000 surplus, and then calculate to be completely free from the necessity of working, because he would have a $4,600 per year income; a "sabbatical year" *every year.* All this is theoretical calculation, but based on the most definite calculation of averages, and assuming of course that every four years will see the degree of advance (and also the degree of deflation) which the last four years have recorded. There is certainly nothing unreasonable in this.

Selected stocks from the general Stock Ex-

change list naturally went far beyond this average increase of 66% in three years; Montgomery Ward & Co. for example; but selected stocks also dropped more than 28%! *The shrewd* common stock investor, who picked his way with analysis and care, purchasing outright, doubtless therefore did even better with his $10,000 invested in 1925. Many wealthy men, naturally, have made larger profit, by being very carefully analytical, but the ordinary corporation employe and the shrewd clerk, mechanic or school teacher have all had precisely the same opportunity to take a long-time point of view based on facts which were open to everyone to study. I propose to give here some actual facts as to the experiences of some investors in common stocks; and though they may ring like wedding bells at a funeral to ears which are now attuned to panic dolefulness, they belong in the "record."

We have been mentioning U. S. Steel stock. It is a "pilot stock"; a world leader in business; a conservative and substantial institution. In 1904, the common stock was actually selling at 8¾. It is hard in November 1929, when it is selling at a low of 150, to see why; and it was still harder in August when it was selling at a high of 261. The corporation was sponsored by Mor-

gan, and headed by Judge Gary, and Charles Schwab, one of Carnegie's brilliant partners, was freely predicting, so that the average man could hear, a day when steel production in America would reach fifty million tons (which is now attained). We were already fully entered upon the great machine age, and the automobile was already visible as a new possibility. But the average man did not see it; nor indeed did many rich men. A great many people were foolishly spending their time on street corners and in village stores cursing Morgan and ridiculing the U. S. Common stock as a "come on" trap for "suckers"; as representing nothing but water; and dolefully fretting about the "panic" on at that time.

But not so our bright Yankee lad, already mentioned in this book, who had resolved to "live on interest money"—George F. Baker. He is the largest single owner of Steel Common Stock, 76,000 shares. Just when he bought it I don't know, but it was many years ago and he has made a minimum of $12,000,000 out of it, even at the low panic prices. If he bought it at 8¾ in 1904 his profit has been about 5,500%. If that isn't fulfilling his boyhood dream of "living on interest money," I do not know what could fulfill it. We have thus the record of one

of the richest men in the world, who has become so largely by buying common stocks *and holding on to them.*

George F. Baker was by no means the only rich man who profited hugely from U. S. Steel stock, while the average man sniffed at it. Frank Munsey, the famous publisher, is reputed to have bought Steel common at 33 and thereby laid the basis for his huge fortune. It is well known that he did not make a great deal of money from his magazines, but his steel holdings made him a very rich man.

A calculation of U. S. Steel shows that allowing for stock dividends and rights a share is equivalent to about $420 a share. Since 1904 stockholders have received $137.50 share in cash dividends. And this stock sold at 8¾ once!

There are of course many other remarkable calculations possible; one must refrain from quoting too many. A man who invested $1,000 in F. W. Woolworth common stock (also regarded at time as "water") found it worth $32,000 in 1929—an increase of 3200%. This is not even the most spectacular example among the chain stores. A man who invested $1,000 in the common stock of W. T. Grant & Co., also a five and ten cent chain, found it worth $345,000 in 1929—34,500%! $1,000 invested in the

Kroger stores common represented $105,000 in 1929 and in the Kresge stores common, $115,000. These examples do not seem very much less remarkable when 28% deduction is made for the present panic "lows."

Passing into the motor field for a moment we have similar striking examples. A man who invested $100 in Chrysler Corporation common stock on January 2, 1923 found, 5½ years later, on June 15, 1928 that his investment was worth $1,756.08. If he also at the same time had invested $100 in General Motors common stock it would have been worth $903.40. If he had invested $100 in Packard stock it would have been worth $879.43. If he had invested $100 in Nash stock it would have been worth $801.06. If he had invested $100 in Hudson stock it would have been worth $390.07; and if he had invested $100 in Studebaker stock it would have been worth $143.44.

Now, let us imagine that this man, on January 2, 1923, with only $600 to invest, and noticing that the automobile business was certainly not yet starting to decline, had invested in all six of these motor corporations. His $600 would have grown to $4,873.48; a clear gain in 5½ years—irrespective of cash or stock dividends, of $4,273.48, or at the rate of about $778 per

year. But we are still not through with our calculation. If we should count the dividends in, which amounted to a total of $748.65; giving a grand total of return on the $600 original investment of $5,622.13—thus providing in 5½ years nearly $1,000 a year in return over and above the principle. The return on Chrysler was 17½ to 1. Again I repeat, that even after deducting 28% for the panic low prices, the contrasts do not fade seriously.

1923, after all, is not so long ago, yet most people were already thinking that the automobile companies had "shot their bolt." If we should try to calculate the return on automobile investment made fifteen or twenty years ago we should of course be merely fantastic. The figures would run off the side of the page! Yet fifteen or twenty years is certainly not a genuinely long time to hold common stocks for increase. Our Yankee lad, George F. Baker, has held his steel stock longer still.

Suppose we now turn to bank stocks—which are by no means out of reach of the average man, despite the fact that they have usually been regarded as rich men's investments.

A man or woman who had bought 10 shares of New York Title Guarantee & Trust Co. stock

ten years ago, at a total cost to date of $5,000 would today have 100 shares, and their total profit appreciation and income in August 1929 would have been $17,390; a profit of $13,390 or $1,339 per year. If another man had invested $4,000 in 10 shares of the stock of the Chatham Phoenix Bank of New York his holdings would at the same time have been worth $10,050. A prize example would be a man who had invested $4,550 in the stock of the Central Hanover Bank, and who would have found it worth $24,-400. Another would be a man who had invested $12,350 in the City National Bank, and who would not find it worth $78,755. A cut of 35% or 50% in these calculated profits for panic low valuation would still leave them remarkable.

We will now go on to insurance—another field of investment entirely open to the average man, but which is commonly regarded as a rich man's investment.

Suppose that ten years ago, in 1919, a man had invested his savings at $18,800 in the stock of the Travelers Insurance Co. He might have invested less, but for the purpose of utilizing a recent calculation,* I am going to assume this

* An analysis by the Statistical Department of the Insurance Shares Corporation of Delaware.

arbitrary sum. During these ten years he was given a chance to exercise stock buying rights. Let us say that he utilized these rights, and invested \$5,600 more; a total during the ten years of \$24,400. By August 1929 his investment of this sum would have had a market value of \$167,000. This is a profit of \$142,000, or a return of 580% on his investment. But this is in addition to dividends paid, which amounted to \$8,500 more. Compounded annually, the return on this investment mounted to 23% per year. What the 1929 panic did to this accrued value would also fail to obscure its excellent showing.

Another example will be equally illuminating. Suppose in 1919 a man invested his savings amounting to \$16,800 in the stock of the Connecticut General Life Co. Taking advantage of rights offered him in that period, let us say he invested \$9,600 more. This makes a total of \$26,400. By August 1929 the market value of this investment would have reached \$269,400. This is a profit of \$243,000, or an average of \$24,300 per year, which is actually reaping a reward each year greater than the amount originally invested! Compounded annually it amounts to 29%.

While we are speaking of what are usually but wrongly termed rich men's investments, it

may be just as well to quash with figures the idea that rich men avoid stocks and invest mainly in bonds. The words "bloated bondholder" has clung to the public mind, and cartoonists have usually drawn pictures of "plutocrats" in the pleasant attitude of clipping bond coupons. Those who know the shrewd ways of the wealthier investor have always understood this to be an error. Rich men—as has been shown in the example of Baker—have almost invariably been heavy investors in common stocks, and it is a by-word in the financial district that bankers have built their fortunes by taking their pay in the common stock of corporations they financed.

Now we have some specific figures.* Study of Treasury Department reports under the inheritance tax law shows that the larger the rich man's estate, the greater is the proportion of well-selected common stocks owned. Taking 33 estates over $5,000,000 in size for which records were filed for 1927, it is found that the total wealth was $307,000,000. Only 13%, or $41,000,000 was in bonds, while 64%, or $198,000,000 was in stocks. Only 7% of the holdings was in real estate.

* Study by Helen Slade, "What Rich People Own," in "The Independent Woman," 1929.

This shows what the very rich man thinks of common stocks. The *moderately* wealthy man apparently has not bought quite so much stock. Studying 1,232 estates totalling $50,000 to $100,000, there was found 14% in bonds, 27% in stocks, and 24% in real estate. The average man of money, leaving less than $50,000, again had a different set-up. He had 20% in stocks, 9% in bonds and 39% in real estate. It seems to be pretty clear that the more real estate you have the poorer you are; while the more stocks you own the richer you are!

I do not recommend that any one fire their imaginations too much with figures like these, but they should be recorded. Herewith* is a list of companies and the ordinary amounts (none of them beyond the investment range of the average man or woman) which turned into snug little fortunes in a comparatively few years:

North American	$5400	in	4	yrs.	became	worth	$64,000
Woolworth	5400	"	4	"	"	"	33,000
Maxwell	5000	"	1	"	"	"	40,000
American Can ..	5000	"	5	"	"	"	75,000
Southern R'way	5000	"	4	"	"	"	32,500
Am. Water Wks	5000	"	4	"	"	"	195,000

* Compiled by the Brookmire Economic Service, New York, 1929.

Nat. Biscuit........	$5000	in 6	yrs.	became	worth	$35,000
General Elec......	5000	" 4	"	"	"	30,000
Kresge	5550	" 4	"	"	"	44,000
U. S. Cast Ir. Pipe	5000	" 3	"	"	"	57,500
Cont. Insurance	5000	" 10	"	"	"	27,000
Wright Aero......	4000	" 5	"	"	"	145,000

Cut all these figures (to compensate for panic reductions in values) by 40%, surely liberal enough, and still we have quite remarkable additions to original investment.

Further light is thrown on the success of long-time investment in common stocks when one examines the simple and easily obtainable advice of unbiased periodicals over the past few years. *The Financial World,* New York, for instance, has published during the past five years twenty four "bargain lists" of stocks—mostly common stocks—which it suggested for purchase by readers. These bargain lists are usually quite sound selections, well worthy of the average man's confidence. Let us see what these recommendations, if followed, have meant to investors.

Bargain list No. 1, dated May 15, 1924 contained the following list of stocks, which I have —with some slight proportion of error due to changes in these stocks—re-calculated to show their present "post-panic" status:

	Price Recommended	Price Sept. 3 1929	Net Change	Price Nov. 12 1929
Baltimore & Ohio........	$ 52	$140	+ 88	$110
Chicago & No'western	53	100	+ 47	77
Rock Island 6%........	69	98	+ 29	108
Great Northern..........	57	125	+ 68	90
N. Y. Central..............	100	253	+153	163
American Tel. & Tel.	125	302	+177	203
Columbia Gas	35	238b	+203	55
Consolidated Gas	62	361b	+299	170
Detroit Edison	104	350	+246	180
Laclede Gas	92	261	+169	100
Northern Pacific	51	110	+ 59	80
Pennsylvania Railroad	43	109	+ 66	80
Pere Marquette pfd....	64	94	+ 30	96
Southern Pacific	88	156	+ 68	112
Union Pacific	131	295	+164	203
Pacific Gas	92	366b	+274	100
Philadelphia Company	43	249	+206	160
Public Service	43	383b	+340	110
No. Amer. 10% Stock	24	184	+160	79
Peoples Gas	94	374	+280	224
Totals	1402		3126	2400

There is only one preferred stock in the list, therefore the performance, loss or gain, of the stocks must be credited almost entirely to common stock. The man who bought one share each of these twenty stocks, as advised in 1924 and sold them in September 1929 would have made $3,126

clear on his investment, not counting cash or stock dividends. He would not only have had back his $1,402 invested after 5½ years, with interest, but *over twice as much more*. Very well; forgetting what would have been his gain if he had been wise enough to sell at the top of the market, let us see where the panic left him. He made a clear gain of $1,002 in 5½ years; 71%, or over 12% per year! Surely such a man would have no cause to whimper about the panic!

As the average cost of each group of twenty stocks in each of the *Financial World's* bargain lists was around $1,500, the investor who followed these bargain lists, and regularly and faithfully bought each time the shares recommended, is now despite the panic, in a most enviable financial position. The bargain list appeared on an average of about once every three months, so that the man who could afford $500 a month to invest was able to take advantage of all the bargain lists. In September 1929 he would have stood, at the end of the 5½ years, in this position: He would have invested a total of about $36,000, and this sum, a small fortune, would have grown to a substantial fortune; $27,224 having been added to it, and representing a total of approximately $63,000. Cut 30%

of this away as panic loss, and he would have $44,100, or $8,100 as clear gain, or 22%.

I would be most careful to caution the average man to avoid the "bonanza" attitude, or the habitual expectation of miracles or good fortune. He must learn the principle of risk and constantly keep it in mind, buttressing himself against the possibility of *decline* rather than feed himself with anticipations of rise. At the same time we are now in a position, because of the panic, *to face facts realistically;* to figure out precisely what happens to the long-pull investor. *The facts cannot scare the true investor-speculator.*

The average man, I believe I have proved, has a fair hope of enlarging his income through the momentum of progress as we are experiencing it in America, if he will use his intelligence and the brains of others, available to any man at small cost, as was the above "bargain list" information.

Those who paid for more expensive and detailed statistical services have also profited if they acted upon it. For instance, a check-up of the Brookmire recommendation shows that those who took the 1926 recommendations and held the stocks an average of 35 months made 125% on their money. Those who took the

1927 recommendations, holding the stocks an average of 23 months, made 55%, and those who took the 1928 recommendations, holding the stocks an average of one year, made 47%. Over a 3½ year record, 275 stocks were recommended for purchase, and 119 of these were recommended to be sold. The average profit on these 119 sold was over 19%. Of the remaining 156 stocks which were still held, 28 showed a loss, but only of $247. The final balance on these 3½ year transactions shows $18,006.70 profit. Cut this with our estimated 30% panic discount and $13,600 profit remains. Other reputable forecasting services can also show records of achievement for those taking their advice. I mention this merely to indicate that the average man, from sources of information open to him at small expense, has made and can make a definite record of success with common stocks, and there seem to be no reasons why he cannot continue to do so, even if not to the very substantial degree of recent years.

Another bit of striking and authentic evidence of what has been accomplished in investments, largely in common stocks, in recent years, is provided by the contest held by *"Barron's"* the financial weekly, for the best record of judicious investment of $100,000. The winner, Charles

E. Brundage, increased his original investment of $100,000 in two years (1927-1929) to $281,-203. In other words he nearly suceeded in *trebling* his investment. Managing his $100,000 capital, he earned an annual salary, so to speak, of over $90,000; which is a good deal more than the salary of the President of the United States, and more than many railway presidents get. A more impressive record would be hard to find.

But by examining other entrees in this contest, we find that it did not depend upon luck or genius; a number of others increased their original investment, during the same period of time, to very considerable sums. Robert G. Wiese ran his $100,000 up to $223,504; Homer Chapin his to $189,205, and Hazel Freeman, (a prize winner too) to $180,626. The lowest one in the honorable mention list had run his $100,000 to $122,085. A composite of all of them shows $159,249, an annual increase of $29,500 per year. Check this again with the 30% panic discount, and there is still over $12,-000 gain in two years. It would be hard to quarrel with this.

Examples such as these indicate what I mean by providing the average man the same opportunities for profit from investment-speculation as for the wealthy man. Such opportunities can

be made safe and sane, and the common sense of the average man can be trusted. The fact of the matter is that the average man, *on his own initiative,* is breaking away from the investment nursery where some financial leaders have tried to confine him, (while they made large investment-speculation profits themselves, often on the average man's money). It is far better policy to help the average man take his steps into investment-speculation and let him share both its profits and its risks, than to neglect him and let him ill-treat his money, to the detriment of business in general.

The policies which these wealthy men pursued to reach their goal were largely concerned with common stocks. The prize-winner's percentage of bonds to common stocks was 57⅛% common stocks, 4⅛% preferred stocks and 38⅛% bonds. It is most significant to note that no less than 93% of all the 508 contestants advised the business man to put a part of his savings into common stocks. Seventy-one even advised that he put *all* his savings into common stocks. As *Barron's* remarks in reviewing this, "the correctness of this common stock investment theory has been proved already, for unless some stocks had been included (or bonds or preferred stocks with common stock features attached) this business

man's principle would not now be intact and he would have made no progress in building up a satisfactory income." *Barron's* also remarks—significantly for our purposes in this book—"perhaps the most extraordinary outcome of this contest is the practical demonstration that while it may require unusual financial training to secure results such as Mr. Brundage's, nevertheless, highly satisfactory results may be achieved by the average investor who follows fundamental investment principles and who selects securities generally held in high repute and with active markets."

The facts seem to bear out the contention that despite the panic test by fire, the long-pull common stock investor-speculator shows excellent *net gains.*

Chapter VII

The Development of the Average Investor

ALMOST a century ago a boy, whose father was a rather poor shoe store owner, was visiting his relatives in New England. He noticed that all the men-folks of the house, *except Uncle John,* worked hard. Uncle John, although not too old to work, was, however, always taking things easy, rocking himself and airing himself on the front porch.

"Grandma," asked the boy, "why doesn't Uncle John work, like the others?"

"Uncle John," replied grandma, with an air, *"lives on interest money."*

The remark stuck in the boy's mind. He was a very exceptional Yankee boy, and—possibly as a result of that remark—has become one of the two or three richest men in the world today.

He was George F. Baker, the great financier, a common stockholder in a large number of great corporations—the Pullman Company, American Can Co., The American Telegraph & Telephone Company, as well as The New York Central, Jersey Central, Lehigh, Erie, Reading, Lackawanna, Northern Pacific and other railways, as well as banks. As a dramatic fulfilment of his boyish resolve to "live on interest money," he drew one day an interest check of $1,200,000 when the First National Bank of New York paid one of its famous 50% dividends.

George F. Baker is a good example of *the exceptional* man and what he can do; an example of how a rich man can amass still greater wealth by shrewd investment. He, like other rich men, has high-class advisers, experts and statisticians who watch the field of investment for him. No wonder the saying grew "it takes a lot of money to make a lot of money." No wonder ordinary people years ago became restless and said that "the rich were getting richer and the poor were getting poorer." The honest truth was that there was no "parity," no equality of opportunity of profitable investment between the rich man and the average man. The poor man put his small savings in a savings bank at 3% interest while the rich man put his money into good

common stocks, and as the country grew he became wealthy, until his pockets fairly bulged and burst, and he gave away millions of dollars for fear he would be hated for his wealth. But the average upstanding American man does not want to take any man's money away from him. He says "if that Yankee shoe dealer's son had the push and go in him to get to where he is, that's all right with me; I admire him. But what I want is to have the same chance to profit as the rich man; I want access to the kind of information he has, and I want the opportunities for profit to be held open for me as well as for the rich man."

That is precisely what has now transpired. The day of "closed corporations" and tight little banking cliques and opportunities for profit held carefully out of reach of the average man, is now gone. Never before, in America or anywhere else, has investment been made so generally open and available a matter, nor investment information so simply available. Never before has such a large aggregation of business houses offered the public or employes a chance to become part owners. Even instalment buying of stock is readily possible today, whereas 25 years ago there were not even "baby bonds" ($100 bonds) available. Brokerage and invest-

ment offices are everywhere, and trading facilities extended so that one can buy or sell shares even while off in the country on a vacation—indeed, out in the middle of the ocean on a ship. Five or ten share-buyers are almost as well serviced as hundred share buyers. Indeed the urging of the average man to buy stocks has been absolutely *over-done* and was responsible for the stock panic. Both the public and the financial world got the wrong idea—the same old "get-rich-quick" idea rather than the long-time investment-speculation idea.

The thing lacking has been a widespread intelligent realization by the average man or woman of the truth that he can profit from investments on quite the same principle, even if not on the same scale, as the rich man, who alone heretofore has skimmed the rich cream of the country's increases in values. Why should it have been J. P. Morgan and a few other rich men alone who bought U. S. Steel stock at almost zero and held it for years? Why should it have been only an inside few who knew that the southern railways were going to profit largely from the new prosperity of the south? There is no denying that these rich men had information which was quite equally available to any school teacher, clerk or mechanic. The facts and figures

were all widely published. James Patten, the "wheat king," pointed out many times that the large fortunes he made by foreseeing great plenty or great scarcity of wheat were not based on "inside," "private" information. On the contrary, he says he always tried his best to point out and publish the facts to everybody, but got little attention.

Success in buying good common stocks and holding them for "the long pull" is very simple if one uses but the most ordinary common sense, which almost any average man and woman possesses. But it does not and never can or should have the excitement of a horse race or a "crap" game. That is the grave error of the "boob" public. It is time that the average man and woman pay as much intelligent attention to *investing* their surplus, however small, as they do to *earning* it. Otherwise they will deserve the name of common, driven sheep and simpletons, deserving the devastation of the stock panic. Nothing is calculated to disgust one more than the sight of a competent man or woman, full of common sense and intelligence in other things, invest his or her money in some utterly stupid, dangerous manner, or trusting their money to others who know as little or less about it, if they are not downright untrustworthy. *There is no*

substitute for your own brain, nor is there any for common sense. I consider insufficient the old advice to ordinary investors, "go to your banker and absolutely trust him." I am a believer in the average man's development of his own investment program and plan, and the use of banks and bankers as servants, not as masters. Get all the counsel you want, *but make your own decisions.* You need not be technically expert, but you can use caution, courage, care, judgment and logic. If you don't, you will either lose your money or be compelled to accept narrow rates of interest while the wiser ones reap the richer rewards of common stock advancement.

We are undoubtedly in a great era of industrial development which has already lasted about 35 years, and is not going to be stopped by the panic. It is extremely likely to last 25 years more. The broad, underlying momentum is, therefore, forward, not backward, despite setbacks. In such an era the first and foremost thing for any investor, rich or average, is to *make the tide work for him,* like a swimmer in a tide. He should be able to make his money earn a normal interest *plus the rate of the underlying tidal movement.* This is his right and privilege, and only his own stupidity can keep him from it. For this is the age of the average

man and woman; the age of *investment* by the average man and woman. This is an entirely new situation for America and for the average man and woman. We have not known quite what to do about it. For years past, as this new situation has been coming on, nobody did anything, except the fake stock sellers and the sellers of all kinds of "cat-and-dog" securities. They were very busy indeed, and sold the average man and woman from $2,000,000,000 to $5,000,000,000 worth of worthless or very doubtful securities. Meanwhile the bankers were clinging to their regular methods and machinery, just as though nothing had happened. They had always believed that only the well-to-do classes were buyers of securities. Many of them believed there were only about 300,000 people in the country who were interested in buying securities. Most of them were buyers of bonds or selected preferred stocks. Such common stocks as they bought were not from bankers but were very speculative, "chancy" stocks sold to them by friends entering business, or by stock salesmen for promoters whose stocks were either definitely worthless or represented uneconomic, dubious enterprises which had very little chance of success.

The average man at that time not only had

no surplus earnings to invest, or if he did, knew almost nothing about how to invest it wisely—not even how to find competent investment advice. There was no communication between him and investment bankers, and no idea or plan for investment by the common man. The only way the average man knew how to save was by insurance or the savings bank—or in a hiding place! But it was *saving,* not *investment;* his money deposited in the insurance companies and in the savings bank was invested by the bankers themselves—*not for him,* but for the banks and interlocking banking directorates of insurance companies. The huge financial power developed in this way, and the dangers twenty or more years ago of its concentration into a few hands, was illustrated by the insurance scandals unearthed by Charles Evans Hughes, and the strong and even corrupt grip upon it by a man like Ryan who controlled banks and insurance companies and notoriously misused his power, given to him by millions of small savers. Happily the insurance companies of today are strictly regulated and the *mutual* ones in particular share with their policyholders the investment profits made by investing the money paid to them. At the same time a very vigorous effort began to rid the country of fake stock promo-

tion. The Better Business Bureaus and other agencies fought valiantly to drive out the seller of worthless stocks, and while the battle is far from completely won today, and at least a billion dollars' worth are still sold every year, the truth is that the backbone of cat-and-dog stock selling is broken. The further truth is that the 1929 panic has broken the grip of the over-optimistic bankers who attempted to load far too heavy a load of legitimate but over-valued stocks upon the public. This, too, is a great step forward.

Meanwhile, several very remarkable events have occurred in American history, which make investment in good common stocks of great importance, and the understanding by the average man of how to judge good common stocks, even more important.

First "came the war." This suddenly turned 20,000,000 people into security buyers. The most stupendous sales and educational campaign ever conceived before, with three or four million voluntary "salesmen" talking to people in the street and between the acts in theater, persuaded these millions of people to buy "Liberty Bonds," in denominations as low as $50. Stenographers, clerks, farm hands, mechanics and even servants made the acquaintance, for the first time in their lives, *with the method and the machinery of in-*

vestment; a piece of engraved parchment paper representing an investment-bearing interest and quickly saleable on an Exchange, with daily published quotations. It was quite like a new toy, and while a great many of these twenty millions of people quickly sold their Liberty Bonds, others held them, watched the daily quotations, and even learned to both sell and buy, speculatively.

Second, came the new era of high wages and later falling prices, which increased the number of people who had an investable surplus. In 1913 there were only 357,598 people making income tax returns, whereas in 1927, the last year for which figures are available, there were 4,101,547. This is not a strictly comparable figure, but it gives some rough estimate of the increase in number of people who have surplus. In the class of income between $3,000 and $5,000 (which is the level on which investable surplus begins) there were 149,379 income tax payers in 1914, and 1,209,345 in 1927. For 1929 I should estimate that the number will be nearly 2,000,000. However, it is generally admitted that even this figure is quite too low, and is more likely 5,000,000, because of failure on lower levels to report incomes, or because of nontaxable or other income. In the range between

$5,000 and $10,000 a year income, where the figures became more reliable, there were 127,448 in 1914 and 560,549 in 1925; which figure in all likelihood is about 700,000 for 1929.

I am trying to show in these figures proof of the statement that since the War income has so greatly increased that we now have nearly ten times the number of people with some surplus to invest that we had before the war.

Third, there arrived the era of new relationship between employer and employe, and a great increase in the number of employes who have *purchased the stock of the corporations they worked for* (now about 1,250,000). This is a most important development, which has worked out very happily for nearly all employes; but at the same time it demands considerable discrimination as to the value of common stocks, as by no means all employes work for companies whose common stocks are a good investment for them. Here comes to the fore the increased interest on the part of the average man, in knowledge as to how to judge companies and their common stocks. The employe of today is being given the opportunity to become an owner just like other owners; the corporation share method making this perfectly feasible and simple. There is no real difference between an "owner" who

holds *one share* of common stock, and one who holds ten or twenty per cent of all the common stock. Neither owns control; both owners are important to the business.

Fourth, we have developed in America an entirely new understanding of business structure, financing and management. When the corporation idea first came into use it was seized by individuals to extend their individual power, with little or no thought of making it useful to employes or even to society as a whole. It was used very selfishly and shortsightedly, and that is why we had the terrific anti-trust and corporation hatred for so many years.

More broad-guage men coming into power soon saw that the *real* usefulness of the corporation idea was to sub-divide corporation ownership very widely, first among the public, then among employes and finally among customers. Ownership that is too "private" and limited narrows itself too much for real usefulness in a great country like ours. This at once made it possible to get rid of the "barons" of industry and banking; the "overlords" and autocrats who ran things just exactly as suited them personally. It made possible the application of the modern line-and-staff idea, where the functions of work are sub-divided and specialists and experts and

department heads rule, instead of an "owner" or autocrat. This makes the truly American principles of "rule of merit" and "promotion from the inside" far easier to operate, because the thousands of stockholders of a large corporation own control instead of some arbitrary baron or overlord. Even the big bankers today do not really "control" some of our big corporations in the same way that bankers once "controlled" them. The investing public owns a majority of the shares, and the bankers are merely their financial representatives whose duty is to keep the business growing and profitable and popular. In this way, the executives who are elected as presidents or general managers are far more likely than ever before to be men who can wisely lead the organization. We have far fewer "family-owned" businesses today, and we do not, as is still so much the case in Europe, have so many sons and relatives clinging to positions of power so that the ambitious, competent employe has no chance to rise. The genuine secret of America's business supremacy is, therefore, *management* by merit, from the bottom up; and the resulting greater confidence of employes and investing public in these corporations. There is no sound investment, in a company, without

sound management, and the American investor is aware of this.

Fifth, the average American man and woman have cut their wisdom teeth in regard to investing their surplus—especially since the stock panic! They are too sophisticated, now, I believe, to "fall," in the same old way, for stock promoters, even those wearing the respectable vestments of Wall Street, and have now become more familiar with the machinery and method of investment. For the moment chastened by the panic, they are nevertheless deeply interested to know still more about it. They are out of the cradle so far as looking after their money is concerned; and although they still have in some degree the same fault that America has always had—too great a love of chance-taking—they are now certain to be much more careful to see that when they do take a chance, *there really is a chance for them.* The fake stocks sold to them in the past gave them not even "a Chinaman's chance," and the fake values ballybooed by Wall Street were not much better. The average man will be distinctly more wary and investigative from now on. He has shown before that he can learn; and each new step forward in his self-knowledge has been a step toward *independent thinking.*

The average man and woman are not willing—and with good reason—to do what the old-line conservative bankers have wanted them to do; to put their money in savings banks, bonds or even preferred stocks exclusively. No amount of cautioning will make them satisfied with savings bank interest for their moneys. They are sophisticated and read what is going on. They know quite well that the money they put into savings banks is used by bankers to make considerably more than is given them as interest. They know that the great sums of money which the average person turns over to banks is used for "call loans" at high rates, or for the purchase of stocks which increase in value with the growth of the industry and of the country, at a much more rapid rate than ordinary interest accumulation. They do not see why they should be held down to a fixed low rate of interest while the bankers and wealthy investors alone cash in on the cumulative value of good-will and general prosperity and growth, which the average man is after all the chief factor in creating.

The average man, in other words, *seeks a more logical middle ground for himself*. He knows full well that this is indeed an era of the average man and woman; that the age belongs to them, not to a privileged priesthood of a selected few

who skim the cream and give the average man the thin milk. Indeed, many broad-gauge bankers and financial men are perfectly ready to admit this, and are wise enough to want the average man to share in the growth of his country and of prosperity and good-will values. "If we are going to capitalize our great corporations and mergers with the public's money," they reason, "then we must provide the public the same incentives to profit that we have. But of course it is our duty to make them understand the risk factor involved and train them how to guard their funds from disaster by diversifying their investments; show them how to invest part of it with little or no risk, and part of it with intelligent speculative hope of profit. Otherwise we will all ride for a terrible fall."

It is in this way that the intense interest in common stocks has come about among the average man and woman. Common stocks represent the risk, the forward-looking, adventurous part of the investment experience. The average man and woman are thrilled with the brilliant business pace of America, because they are a part of it and help to create it. They resent the idea that they shall not share both its risks and profits. They are fairly good sports, too, in taking losses, as the panic shows. It was not the average man

but bankers who committed suicide, embezzled and broke down physically because of the recent panic losses. From the earliest pioneer days of America, the American people have taken risks, and they do not want to stop now. They do not want to be like the stolid peasants of France who skimp and save to buy a government bond and cannily try to play 100% safe. They know that this peasant has had to accept 20 cents on the dollar of his supposedly 100% safe French government bond, and that, therefore, he took a risk despite himself—as we all do and must.

Sixth—the average man's investment interest has been concentrated on common stocks by the discoveries of statisticians. The statisticians and financial sharps in recent years have uncovered the fact that the man who invested liberally in common stocks—in spite of their admitted greater risk—was proved to be better off than the one who invested in bonds, because bond owner's dollar depreciated with the declining purchasing power of the dollar, whereas the common stock owner's dollar in all likelihood *increased* in value, since the change in the dollar's purchasing power was reflected in market values of common stocks. To put it more clearly: The man who, ten or twenty years ago, bought $1,000 worth of bonds at a 5½% rate of interest, has

today his $1,000—but those thousand dollars won't buy what they would have bought at the time he invested. Nor does the set and fixed rate of interest, 5½%, represent the same liberal rate of interest today that it did at the time of purchase. The common stock buyer, on the other hand, has working with him the *flexible* nature of common stock valuation—as contrasted with the *fixed* valuation of bonds. The common stock's value is set by the market and by money and business conditions. If they rise, the stock rises in quick response. Of course, if they *fall,* the stock also falls—that is the risk element, which is very much less in the case of a bond or preferred stock. But the point is that common stocks give the average man and woman a practical chance to be what J. Pierpont Morgan once advised everybody to be—a "bull" on the future of America. I venture to say that if it had been possible for the average man and woman to take J. P.'s advice *when he gave it,* twenty odd years ago, the level of wealth would have been twice as great in the U. S. as it is today. The proof—with plenty to spare—lies in the very stock which Morgan had in mind at the time—the U. S. Steel Corporation, which was then selling at about 27—and thousands of people sneering at it as mere "water," at that! Today, as I

write, the market price is 160—a low point after the panic, but far above the price when Morgan spoke! About the only "average man" who shared at all in this rise are some of the old employes who bought stock at a low price and are now fairly wealthy. The average man, at the time Morgan was giving his advice, was buying billions of dollars worth of fake oil and copper stocks and other "investments" which are mere waste paper today. Had these billions been invested in Steel or other good common stocks many an old or middle-aged man now dependent would instead be independent, even wealthy. Quite true, there are some corporations, even those in which Morgan was interested, which also were losses. But these were normal, limited risks, whereas the "cat-and-dog" stocks were completely abnormal, unlimited risks; almost certain losses; and the average man could easily have held himself to taking only normal risks if he had practiced only a few of the rules this book provides. Intelligently selected common stocks are actually the average man's only genuine chance for "parity" or equality with the rich man in opportunity.

Seventh, the general intelligence and enterprise of America in the last ten or fifteen years has changed the conceptions of value, risk, and

opportunity—even after the panic inflation is squeezed out. Business itself—as distinct from the stock market—is much more stable today. We are operating business on a bigger scale, better capitalized and better built to withstand shocks. In the third place, we know more about management and technique. In the fourth place, we practice more cooperation, more simplification, more standardization, and more research and scientific analysis. In the fifth place, we operate higher standards of business ethics cooperation, more simplification, more standardization, and more research and scientific analysis; and also more humane relationships with labor, which reduce friction and risk, and lessen government antagonism.

These five factors alone have cut down by half, I estimate, the uncertainties of business, *for the basically sound, selected business houses of the country,* which are the only ones I propose to take into account in this book, because their common stocks are the only ones which have real hope of profit, with a degree of risk which is not too great for the average man or woman.

One of the most significant lessons possible to imagine for the average man or woman with money to invest is now to be seen in finance. The bankers—quite with honorable intentions—are

aiming to push the "public" out of the stock market, in the belief that it was the public which by its rush to speculate toppled over the great inflated structure of values by becoming "panicky." The idea is that such a cleansing of the market is necessary to get securities "into strong hands" so that the fluctuations and uncertainty will cease. But in effect, what do we see? The same old caricatured operation of the "shearing of the lambs" by the same old insiders of the financial district. We see the small investor *selling* his stocks at precisely the *worst possible* time to sell—while the insiders, in the noble guise of saviors of the market, *buying* at the very *finest* time to buy! This is outrageously unfortunate and wrong, for the public will once again be invited to buy *some other time* when values are high and inflation is once more mounting.

This is of course the great basic paradox, and the Wall Street men of wealth cannot be blamed, because they are performing a public service in trying to strengthen the market. But the fact cannot be dodged, from the point of view of the average man, the investor-speculator, that his interest, like the rich man's lies *in buying common stocks when they are low in price*—which is *now*. The conscientious banker feels a natural hesitancy in suggesting to the public that it buy, be-

cause in times of panic he is himself much more nervous and fearsome than he is during a period of rising values. The futher paradox and unfortunate truth is that he is then, during the less attractive period of *rising* values, far more ready to urge the average man to buy than he is at the present time, which is the average man's greatest harvest time as an investment-speculator!

Here is demonstrated the fact that the average man must learn to do a great deal of thinking for himself; not without the aid of honest, conscientious financial advisers, but certainly on his own courage and sagacity. It is ridiculous, unfair, and unsound, to say nothing of a breach of trust,—even if there is a human excuse—that the financial world tends to advise the average man to buy stocks at just the *wrong* time instead of the *right* time to buy. The handicap can be overcome by greater education in investment matters by the average man, so that he will understand the situation, which is a psychological one, and act like an adult and not like a scared child. There was a Wall Street wiseacre who once said "*buy* stocks when things look absolutely blackest and most discouraging and when everybody seems sure that things are going to the demnition bow-wows. *Sell* when everybody thinks prosperity is most marvelous and secure."

How many people in the U. S. have incomes which place them in a class above the average? Dr. Willford I. King of the National Bureau of Economic Research has just completed a new study of shifts in income concentration, and he indicates that 99% of the income earning population, (44,673,550 people in 1926), have an income limit of $8,700 per year. This is a limit which coincides with what I mean by the average man. Eighty-nine one-hundredths of one percent, or 402,062, have an annual income between $8,700 and $43,750; while one-tenth of one percent, or 40,207 people, have an income between $43,750 and $183,000, and one-*hundredth* of one percent, 4,467, have an income of over $183,000. Dr. King also gives statistics as to the rise of the average man's income (see chart) showing the growing investment position of the average man, and the relatively declining position of the rich man.

These figures demonstrate the main thesis of this book, that we should consider the average man more. Investment has heretofore been thought of mainly from the point of view of the 1% of people whose incomes are over $8,700, whereas the *average* man's investments, the surplusses of the 99%, must now be considered vitally important.

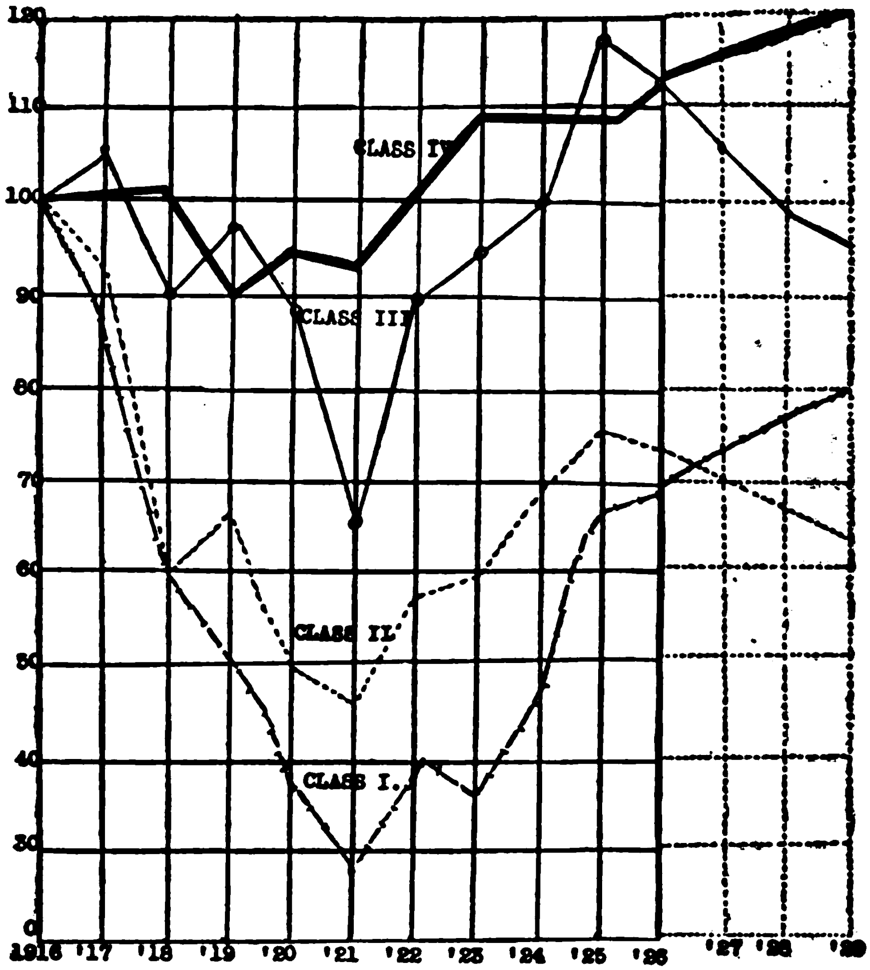


Chart Showing Changes in Per Capita Incomes By Years of Four Classes of People: I, the richest one-hundredth of 1%; II, the richest one-tenth of 1%; III, the richest 1%, minus classes I and II; IV, the 99% of the people.

This chart is based on the work of Dr. Willford I. King for the National Bureau of Economic Research, and the author has extended these figures, on an estimate, for 1927, 1928, 1929 to show the tendencies continuing.

Chapter VIII

How Widely Does the Average Man Already Own Common Stock?

WHEN I speak of the desirability of the average man and woman owning common stock, I am urging something which is already widely practiced. The "money-wise" average men and women are increasing very rapidly indeed—few people realize *how* rapidly.

Take the case of Armour & Co., great meat packers. There is no more dramatic example in all America for my point; the "de-baronization" of a great business, and its conversion into a financial democracy. Its story sounds a bit like the story of Germany's overthrow of autocracy and change into a republic, to the greater happiness and efficiency of all concerned.

The story of old Phil Armour, who founded the business, is one of America's vivid stories.

He was a great old fighter and autocrat, a builder and an organizer. He built up his business to a hundred million dollar business, and its momentum was so great that it went to 500 millions shortly after he died. *All the stock was owned by the Armour family.* Up to ten years ago the common stock of this huge concern was in just exactly *nine hands.*

But, frankly, the "rich man's son" J. Ogden Armour, though a fine, well-meaning man, was not another "Phil" Armour; he could not master the great business left in his lap, nor meet the peculiar storms and stresses of modern times. As he once said "I thought I was the most fortunate young man in the world when I inherited a huge business and a good name, but it was not long before I changed my views, for I had nothing but trouble." Then came a terrible crash, and J. Ogden Armour lost all of his many millions, establishing a record for losing the most money in the least time. Control of Armour & Co. passed out of his hands, of course. An autocracy became quickly a democracy. The weakness of the "family" system of ownership was never more conclusively shown. The "crown prince" of the Armour family died a saddened man, his power and place struck from his hands. At one time he was worth 200 million dollars,

but when he died he was actually in debt 3 million dollars.

In the place of power now is F. Edson White who started as an $18 a week clerk and for 27 years toiled up the ranks. Today Armour & Co. is owned by many thousands of people, *most of them Armour employes.* 52,372 shareholders out of the total of 78,961 hold only small amounts of shares—1 to 24 shares, while 8,628 more own from 25 to 49 shares. Only 17,961 shareholders —22% of the total—own 50 shares or more. Certainly this once autocratic, privately owned firm is now a fine "Exhibit A" for a modern publicly owned corporation, when average men and women own 78% of its stock in small blocks! But of course many other corporations are gradually passing into the public's hands. The U. S. Steel Corporation sent out dividend checks in October 1929 to a greater number of common stockholders than ever before in its history—to 110,116 common stock owners. Incidentally the total sum of quarterly common stock dividends thus disbursed was 14 million dollars, which is at the rate of 56 millions of dollars per year to common stockholders. The preferred stockholders number 63,647. The common stock of this grant corporation now totals slightly over one million shares. And this is what they once called

"water!" 110,116 common stock shareholders is a very large number of people. It is equal in number to every man, woman and child in the city of Fort Wayne, Indiana, Reading, Pa., or Spokane, Wash.

Two other great American corporations are notable for their large number of stockholders—The General Motors Corporation and the American Telephone and Telegraph Co. The record of the General Motors Corporation is particularly startling. In 1917 it had only 2,920 stockholders; but during the next year it nearly doubled the number. During 1919 however—just after the war—the number gave a perfectly amazing jump, from 4,739 to 18,214. Large numbers of employes and large numbers of people selling their Liberty Bonds must have selected the General Motors Corporation in that year, quadrupling the number of stockholders. In the next year even this number was doubled, and in the following year, 1921 it was almost doubled again. By this time there were 66,837 stockholders. Up to 1924 the number stayed about the same, and then in 1925 actually declined, but in 1928 it rose to 71,185.

In 1929 it took one more tremendous jump—to 140,113. Out of these 117,767 are *common* stockholders. There are only 22,346 preferred

and debenture stockholders. Thus in 12 years there has been an increase of 47 times the number of stockholders!

The American Tel. and Tel. Co. record is less spectacular, but also striking. In eight years the number of stockholders has increased from 140,000 to 450,000. No other corporation in the world has so many stockholders. Not one of these owns as much as 1% of the stock! Here is a remarkable example of modern diffused ownership.

If we now add up the number of stockholders of only these four great companies—U. S. Steel, Armour & Co., General Motors Corporation, and American Tel. and Tel. Co.—we have a total of 779,190 people, which makes a city as large as San Francisco and Atlanta, Georgia, combined.

While it is difficult, because of duplication of names, to estimate the complete total number of stockholders in the U. S., various authorities have agreed that it cannot be less than 15,000,000. And it is constantly growing! There is plenty of evidence that the common stocks of good companies are now getting the attention which the average man once mistakenly gave to unworthy stocks of which no one knew much and which invariably were a dead loss. We are about through with the silly American "bonanza" "get-rich-quick

Wallingford" and slick promoter period, and the result is that we are all more prosperous.

It is quite startling to dig into the income tax figures and find how much the average person, with an income under $10,000, already makes from his investments. It is a revelation to find that the person in this class obtains only 48% of his total income, on the average, from wages or salaries. The other 52% of his or her income comes from sources other than from pay for work done. It comes from profits, etc. Profits from the sale of real estate, stocks, bonds, etc., amount to 2.7% of each persons total income, on the average, while, in addition 9.1% of each person's total income comes from interest and investments, and 6.3% more comes from dividends. This makes a total of 18.1% of each average person's income (in the group up to $10,000 a year income) from investments. This total is staggering, in dollars. It runs into 2½ billion dollars a year—all of which goes into the pockets of the average man and woman.

Of course the *rich* man and woman have made 3¼ billion dollars in dividends as compared with less than one billion by people earning less than $10,000 a year, which demonstrates the theme of this book, that the rich man has been out-pointing the average man in the use of his surplus funds.

The rich man has made a billion dollars a year from the sale of assets held more than two years, and the average man almost *nothing*. This is another argument for long-time investment by the average man.

James S. McCoy, actuary of the U. S. Treasury, says that 95% of wealthy people get their income from stock dividends, although millionaires own less than 7% of stocks. He also adds significantly that a total of 100,000 widows are solely dependent for their income on stock dividends.

Has the panic slowed up the public's stock ownership? Reports of "hundreds of thousands" of small investors sold out, and talk of the "shaking out of the small, weak investors" would appear to indicate that there are now far fewer average investors. This is misleading. It is a fact that when "hundreds of thousands" went out of the market and gave up their securities, *other* "hundreds of thousands" rushed in to buy, and it is the authentic observation that it is a *different* public. The small, gambling margin traders were superseded by *outright buyers* at bargain prices. The proof of this would be in the stock registry offices. The Pennsylvania Railroad during October 1929 *gained 3,050 new stockholders!* Another large corporation reports

that 6,000 new stockholders went into their transfer books during the three week "panic period" of October-November 1929—at the very time that this company's stock was slipping rather fast. The curious fact appears to be that stockholders increase in number not only when stocks are high (3,000 being added during the high price period during September) but also to twice the degree, when stocks are low.

A general result of the stock panic has been to increase the solicitude of large corporations as to their number of stockholders. It has long been part of the policy of such corporations to value their stockholders and desire widespread stock ownership. The selling out of many small investors has made some corporations fearful lest the tendency have a setback. On the contrary, in some cases it has increased the number of stockholders on the transfer books; this no doubt indicating that many who had bought on margin now have resolved to own outright.

At the end of 1929 slightly more than 2,000,000 persons in the United States were holders of securities of public utility companies serving them, according to a survey of the growth of customer-ownership in the electric power and light industry.* 275 utility companies now employ

* Made by Craig & Nelson.

the customer-ownership plan for distributing securities.

There are about 20,500,000 shares of electric power and light stocks in the hands of customers using the companies' services, comparing with nearly 19,000,000 shares at the end of 1928.

The Midwest Utilities Co. is one of the concerns which has for some time past made vigorous efforts to spread its stock. At the end of 1928 the public held 8% of its common stock, whereas at the end of 1929 it holds 20%. Over one billion dollars in such stocks of the company is owned by the public; by 500,000 stockholders. President Insull outlines the policy as follows:

> "The whole financial structure of the system necessarily rests upon the foundation of common stocks in the hands of the public and the financial strength of the structure will necessarily be dependent largely on what percentage common stocks bear to the total capitalization. As it is our policy to keep in the treasury of the holding companies all the common stock of the operating companies, this foundation must necessarily be the common stocks of the holding companies sold to the public. The whole plan of the refinancing of the Middle West Utilities Co. had this in view. By calling notes, prior lien and preferred stocks and replacing them to a considerable amount by common stock we have increased and strengthened the foundation, and reduced the structure that rests upon it."

Chapter IX

Should An Employe Buy His Company's Common Stock?

THE stock panic has suddenly pushed the subject of employe stock ownership into the arena for discussion as never before. Can it survive the panic test?

Nothing in the entire business situation in the U. S. has been more remarkable than the extent to which employes now share in the profits of employing corporations *through ownership of their stocks.* The total is estimated to reach 1½ billion dollars, invested by a total of about 1,250,000 employes.

The tradition is a solidly based one, vitally allied with our modern ideas of labor relations. Carnegie's partnership plans with his famous staff of executives, among whom was Schwab, perhaps began this modern idea, although partic-

ularly faithful employes have been *given* stock in companies for many decades past. The new idea is to let them buy it, and grow in wealth as the company progresses. That they do grow in wealth is attested by the fact that Durant is credited with having "made" a dozen or twenty millionaires among his executive aides who bought General Motors stock years ago.

Although the U. S. Steel Corporation and others have long provided its employes a chance to buy stock, the real impetus came during and after the war when the workingman was for the first time taken into the financial family, so to speak. He was switched from his war-time Liberty Loan bond buying habit, before he could slump back to the old standards, to the fixed habit of buying shares in his own company. That habit has been growing for fifteen years with a very sure forward march. In 1925 I calculated that about 13% of employes of corporations were stockholders of their companies, but I now calculate that this figure in 1929 is at least 20%, which is a growth of more than 1% per year.

A very excellent instance for clinical examination is the Standard Oil Co. of New Jersey. Nearly 25,000 employes of this corporation own stock in the company, and this is nearly one-half of the total number of stockholders; although

these employes hold only 5 or 6% of the total stock. Their average holding is about $2,000. Under two stock purchase plans which have been in operation, 900,000 shares of the stock were bought by employes at an average of about $37 per share. In January 1929 a new plan, in addition to the two mentioned, was begun, and 85,000 shares more were bought, at an average of $50 a share. These are simply the *workingmen's* ownership of stock; a great many of the executives and sub-executives have purchased much other stock in the open market. Naturally, all this buying, by both workmen and executives, is on an investor-speculator basis.

Now, at this particular time it is possible to judge the situation from the point of view which has most often been argued against it—the loss to the employe through stock market declines. The most drastic decline since 1907 was experienced in October-November 1929, but the employes of this company certainly suffered no catastrophe. It is true that early in the fall of 1929, during the boom, the Standard Oil of N. J. employes (not including the executives) had "paper profits" totalling $41,000,000. The price went up to 80. But the stock, after the first big "smash," was quoted at 72, and after the second and heaviest smash 63. The employes

were able to keep a fair part of the accrued market valuation, and were at no time in real danger.

Another company, the American Tel. and Tel. Co., (whose shares dipped over 100 points in the panic) has over 200,000 employe shareholders. 25,000 employes (65% of the total) at the Western Electric Hawthorne Works bought 125,000 shares of Am. Tel. and Tel. stock at an old employes rate of $130 a share, before the new rate of $150 went into effect, Sept. 1, 1929; a rate of course below the market price, which reached a high of 303, and then dropped back after the last major slump to around 230. Thus the fluctuations in a wild panic market were in no sense detrimental to the employes who had not bought on margin. The number of shares a worker may purchase at one time is limited by the amount of his wages; and is sold under two systems. One way allows one share for every $300 salary or wage, payable at 75 cents per week. The new plan changes this to one share for every $400, at $1 per week.

These are examples of the safeguards thrown around the danger of drastic stock smashes and their impairment of the worker's original capital; and it indicates how thoroughly in keeping with the sound *investor-speculator* principle the plan

of employe stock-ownership is when operated by a strong and responsible company. There is no doubt whatever that there are examples of companies whose stocks dipped considerably below prices paid by employes, and in some cases will not for some time go back to the point of price paid. This carries its lesson, already learned by the more experienced companies, that prices at which stocks are sold to employes should be well below the speculative level.

There are now nearly a million employe stockholders in just 24 selected corporations,* and they comprise 25% of the total stockholders of these corporations. The average holding is about $1,200 per employe.

Before going further into this subject, the most unusual of all developments of this character should be cited; the Graybar Electric Co.'s *complete sale of control of the company* to officers, executives *and employes*. There are about 2,000 employes in this company with an average length of service of 15 years. All who had worked for the company for more than six months

* The corporations are: American Sugar Refining; Am. Tel. and Tel., Bethlehem Steel, Brooklyn Edison, H. L. Doherty, Eastman Kodak, Illinois Central, International Harvester, Lehigh Coal, Lehigh Valley RR., Long Bell Lumber, National Biscuit, New York Central RR., Philadelphia Elec., Phila. Rapid Transit, Proctor & Gamble, Pure Oil, Radio Corp. of Am., Standard Oil Co. of N. J., of N. Y., of Indiana, Swift & Co., U. S. Steel Corp.

were invited to buy into the company, and a set-up of $6,000,000 preferred stock and $3,-000,000 was made. By restricting the buying rights on a three-point basis (1) position, (2) salary or wage, (3) length of service, a wide-spread and sound distribution was secured together with appropriate stock-voting voice in the company's control. Payment is either (1) in full, (2) annual instalments, or (3) $2.00 per month per share, with 6% interest. The stock is non-transferable except to the company, at any time, at par value. The Dennison Mfg. Co. is now also in the hands of employes.

Here is a more or less revolutionary plan, which is an augury of how far employes can go in stock ownership under the new conception of ownership by workers.

There seems no doubt but that employe stock ownership plans operated by very large and able companies is a good thing for all concerned, but the crux of the discussion centers around the lesser known company, which is a far greater risk since it cannot offer anything like the same investor-speculator possibilities to employes. An employe of a company whose stock is not listed on the large exchanges would be well advised to deliberate very carefully about buying his employer's stock. He should ask the advice of his

bank or banker. Some small new companies have induced employes to buy stock, who have sometimes lost all their money. No company is justified in offering stock to employes if it has no record of earnings and no stabilized position and value. Particularly no newly promoted company should offer stock to employes. These are basic rules upon which there can be no controversy.

What about the general advisability of employe stock ownership? The U. S. Bureau of Labor, in making an analysis of the subject, has said that workingmen should defer for ten years the purchase of stock until they had purchased insurance, bought a home and established a savings account. I cannot agree with this dictum. It loses to the employe the power of time working for his benefit. If the stock of a strong employing company is of the right type and the terms fair, an employe, in nine cases out of ten, will buy it without missing the money, even if he is buying insurance and a house at the same time; and will find it a particularly good investment-speculation. It is the old story of incentives and fixed obligations, and their valuable stimulation to progress. Having willingly laid a fair amount of harness on his back, the average man usually puts forth the necessary effort to carry it successfully. The ownership of

common stock, as a rule gaining in value while being paid for, and wisely offered to employes at a price well below market fluctuations, is a source of pride and interest and even enthusiasm, and a powerful aid to habits of industry, thrift and productiveness.

It is just as important to look frankly at the *speculative* advantages and disadvantages. It must be admitted that employes of some corporations—mainly executives and sub-executives—develop a marked passion for speculation in the shares of their company, and give a great deal of attention to it. During the boom the entire sales and office staffs of some companies were agog with speculative excitement. Just why they selected their own company as a speculation is not easy to fathom, except that they imagined they were "in on the know" of developments. But market action often is without a basis of information except rumor, and the top executives of such corporations have often deplored such speculative activity and warned employes against it. This has had little or no effect in boom times. Paper profits in high figures have sometimes been rolled up by such executives, and when the crash came they suffered losses—although some of these were only paper losses, and the original purchase price in most instances was not lost, if

purchases were outright. A large corporation office or factory is often a hotbed of rumor at such times concerning new developments, and sometimes, as in the case of the United Engineering and Foundry Co., the president has actually to issue a statement to employes lest they gamble too optimistically in the company's stocks on the strength of a rumor of profitable developments to come. W. R. Hearst went so far as to expressly forbid his employes to speculate, saying that "no one who spends any considerable portion of his time looking at the ticker and thinking about whether stocks are going up or down can give the undivided attention which our contracts call for."

These are of course some of the human factors that crop up in relation to employe stock ownership, but they are in no way fatal to the basic idea. Factory workmen are not nearly so much involved as executives in these speculative excesses. The U. S. Bureau of Labor discourages the average man from giving any consideration whatever to the speculative feature of his investment. It desires him to be an investor, pure and simple, and not an investor-speculator. It takes an ultra-conservative view, which in my opinion is out of key with the facts of human nature and present-day points of view. It says: "If there

is sound basis for expecting an increase in the value of the stocks it will have been foreseen by persons more conversant with the stock market than the industrial employe, and if it is not well assured it is the height of folly for the employe or any other person who can not afford to lose the money to make such investments. Even if the employe is fortunate enough to sell at an advance, the question of the reinvestment of the money presents a new problem with which he is not qualified to cope."

This is certainly the viewpoint of two decades ago and not adjusted to the attitude of the more sophisticated worker of today. Putting him entirely in the "nursery" along with women, as regards investments, is an injustice to the greater literacy and the shrewder common sense of modern employes. In any event, they simply *won't follow* such advice. The die is cast; the American workman has struck out for investment adulthood, and he is through with the nurseries. He is at the same time more or less through with the trick teething rings of the nursery, namely the buying of fake oil and mining stocks and "cats and dogs" generally. If he is not permitted to hope for a share in advance of values—the same incentive that drives employers and bankers—he will slump in his interest in all investment.

There are three types of terms under which stock is usually sold to employes. The first plan, which is followed by a considerable number of corporations, is to buy the stock in the open market and sell it to the employes on the instalment plan, by means of deductions from wages or salaries. In some cases the commercial rate of interest is charged on the unpaid amounts but the dividends on the purchased stock more than offset the interest charges. The second and more common policy is to sell the stock, either purchased in the market or newly issued from the corporation treasury, at a rate below the regular market price. In this case also the stock is paid for by partial payments, and dividends which overbalance the interest charges are credited to the buyer.

The third plan, which is not so common as the second, is to offer the stock at market value or even above it, but giving some special reward or bonus in addition to the dividends allowed under the other plans. In order to secure the additional bonus, the employe may be required to carry the subscription to the final payments, or it may depend upon continued employment and ownership of the stock. Nearly all of the plans provide that an employe may voluntarily cancel his subscription, with, in a majority of the cases,

repayment by the company of all employe instalments, together with at least a fair rate of interest. The Standard Oil Cos. of N. Y. and N. J. permit employes to invest up to 10 per cent of their salaries in the purchase of stock and the company pays into their account 50 cents for each dollar the employe invests. The first plan, which terminated on Oct. 23, 1928, resulted in the sale of 820,700 shares of stock to more than 16,000 employes.

The General Motors Corporation has a special plan worthy of note. It has offered to employes the 7% preferred stock on a basis where any employe may buy each year a maximum of 10 shares at a price fixed each year. Part payment on these shares may be made from returns on the investment trust operated by the company for its employes, or from wages. Then as an incentive employes are paid each year for five years *an extra payment of $2 a share in addition to dividends,* as long as the employe remains with the corporation and holds the stock. This bonus method is one of the most benevolent of all attributes of employe ownership. It is operated by the Proctor & Gamble Company and other liberal corporations.

It is of the greatest importance to remember that in probably more than half of the stock-sell-

ing plans, employes are not allowed to pay in full for the stock but may pay only in exact accord with the prescribed schedule of instalments, so that the payments must be protracted for periods varying from about one year to five years or even longer. The shares are usually not delivered to the employes as fast as they are paid for but held until the whole subscription is paid, and in several cases where the employes are allowed to anticipate the regular payments the stock is not delivered to them until the normal term has elapsed.

In a few instances the employes are guaranteed against a reduction in the value of the securities purchased by them, but in nearly all the plans the employe is left exposed—as I think he should be—to the full sweep of security fluctuations. The reduction or stoppage of dividends means a real loss to the small investor, although there may be difference in opinion as to whether a temporary drop in principal values constitutes a real loss if dividends are maintained. *It is important that the American workman not be coddled,* and that he should grasp fully the idea of *risk* as the natural accompaniment of the hope of gain. This is a most salutary part of his economic education.

Employers are sometimes urged by employes

themselves to make the stock available on a part payment plan. It is particularly noteworthy that during the stock panic this was the case in a few instances, the employes realizing the fact that panic-time is the greatest of all bargain times. Thus Gerald Swope, president of the General Electric Co. was asked by General Electric employes to set up a plan to subscribe to common stock, payments to be made out of wages. General Electric stock, dropped from 403 to 206. Mr. Swope made this reply:

"You no doubt know that some seven or eight years ago the Company offered 50,000 shares of its common stock to employees at a price that netted about $112 per share (this was the old stock). Shortly thereafter the market price went below the subscription price and a number of our employes, being nervous in regard to their subscriptions, cancelled them. Then still later the employes who had retained their subscriptions completed the payments and received the stock, but when the market price went up nearly all, and especially the moderate investors for whom the plan was advised, sold their holdings. No one could find any fault with this. The unfortunate part, however, was that some of these people, who took their profits, invested in other securities which they thought would go up and

in many instances were disappointed; in fact, in some cases that came to my attention they actually lost their entire savings.

"The foregoing shows how the moderate investor in stock regards market fluctuations, with nervousness at declines and desire to take profit on advances. To remove this nervousness and temptation from the minds of the employes, the General Electric Securities Corporation was organized, 25 per cent of whose funds, more or less, shall be invested in General Electric stock and the balance of the investment in stocks of public utility companies.

"Upwards of 34,000 employes now have invested over $36,000,000 in bonds of this company, with a return to them of 8 per cent, paid semi-annually. Employes, furthermore, may acquire G. E. Employes Securities Corporation bonds by weekly or monthly deductions from their pay, and when these savings have accumulated sufficiently they are then in position to buy a share or more of General Electric stock, if that seems both wise and desirable to them at that time, and then continue their weekly or monthly savings in G. E. Securities Corporation bonds."

It is worth while noting that it is not only industrial firms whose employes are buying stock, but also the chain stores, department stores,

banks, etc. An analysis by J. G. Donley * indicates that there are 40,964 employe stockholders in 32 chain store groups, which include Woolworths, Penney, Kroger, Safeway, Shraffts', United Cigar Stores, etc. It also includes the two big mail order houses. Sears Roebuck has more employe stockholders (18,-174) than all the other stockholders in the company combined. Montgomery Ward & Co. has 4,500 employe stockholders. Woolworth has 3,250 out of a total of 14,541, Kroger 1,700 out of 7,000. In passing it is interesting to note that the chain stores are owned by a total of over 172,704 stockholders of all kinds; 23% of these being employes of the chains. In the chains where employe ownership is most heavily stressed, it is significant that the greatest business gains are shown. Thus, for instance, the Penney stores showed the largest gain of any chain group in 1928, and after the panic its stock was selling at the highest ratio of price-to-earnings of any chain store (16.4); the average for all chains being 11.8.

In many of the companies whose stocks have had the most spectacular rise, the plan has been so recent that the subscribers have not had time to complete their payments and take possession

* Chain Store Review, November, 1929.

of their stocks, and sell at the high peak of 1929; but there are many others which have been in effect long enough so that part or all of the employes have participated in the enhanced values of the stocks, which in a few cases reach really enormous figures. Among various companies cited as having more or less spectacular increases in the selling value of their stocks is one of the motor companies which sold the common stock to employes in 1919 at $100, which was par at that time. Since then there have been numerous stock dividends, in the first of which holders of the stock received shares of both common and preferred stock. By 1927 this and subsequent stock dividends had brought the value of the original $100 to $4,331.25 and in addition the regular and extra cash dividends had greatly increased the income from the stock. *No* panic could dip deep enough to take away even a very large slice of these profits.

A most striking and significant fact about the October 1929 stock panic was that the stock-owning employes of corporations *were not among the panic striken,* but on the contrary in some instances formed pools to buy more of their employing corporation stocks, knowing full well how cheap they were at the lows of the panic period. For instance, most of the gain in number of

stockholders of the Pennsylvania Railroad during the panic period *consisted of employes.*

The American Radiator Co. and Standard Sanitary Corporation advanced its regular semimonthly pay day a few days *in order that its employes could get into the stock market and buy.* This is surely a remarkable incident in American life. Pay checks already made out and dated Oct. 31 were re-dated Oct. 29 so that this could be done. The corporation made banking arrangements to facilitate cashing. The company's shares dropped from a year's high of 55 to 28. The employes bought fearlessly.

Another example was that of DeForest Radio whose employes called upon the president and told him that they had formed a pool within the company to buy 25,000 shares in one day. The stock had sunk to 5⅝, but went back to 9¼.

Another interesting situation was that of Sears, Roebuck & Co. whose famous president, Julius Rosenwald, personally guaranteed the stock market accounts of over 40,000 employes to prevent them from losing their savings. But this protection was of course for investments in other stocks, not the company's, which were in no danger at all.

However, some large corporations, at the time when conditions looked blackest, did take specific

steps of their own to protect employe stockholders, by making loans on the stock held, at prices above the market. This was done by the U. S. Steel Corporation. The Standard Oil Company of New York accepted its own shares from employes at a price $11 above the market, usually in order to prevent these shares from being sold as collateral.

The Baltimore & Ohio Railway has made a remarkable record in employe good-will relationships, and now, at the panic low period, it has taken steps to issue new stock especially to be sold at par to employes. The plan calls for permitting employes to purchase one share of stock for each $500 of average annual compensation, but not to exceed ten shares, to be paid for in about three years. It is estimated that 150,000 shares will be taken up.

The Proctor & Gamble employe stock plan is rather unique. Five percent of the annual wage is deducted for stock purchase. Dividends come due when the first share of stock is paid for. By special provision, the employe's first $1,000 worth of stock costs him only $300. This highly stimulates employes to become stockholders. Some amazing individual examples of employe stockholders are afforded by this company. Louis Shutte, a blacksmith, has saved enough over a

period of years to own 600 shares from which he earns in dividends over $3,000 a year; which is more than his wages! Charlie Bateman is another example. He began at $15 a week, now earns about $35 and has also bought nearly 600 shares of stock, plus a $15,000 home.

In 1928 the National Industrial Conference Board made a survey which indicated that a general average of 23.2% of employes in more than 400 companies had bought shares in their employing company; their average subscription being $1,313. At that time the Phila. Rapid Transit had the largest proportion of common stock held by employes (27.81%), Proctor & Gamble 11.6%, Swift & Company 11.39%, Eastman Kodak 8.44%, International Harvester 7.16%.

In addition to the 49,201 employes in the Steel Corporation who were registered stockholders at the close of 1928, there were 19,849 more who were paying for stock on instalments; one-fifth of these having since completed payments. The remainder, about 16,000, were still paying for stock during the panic period, and had no desire to back out.

In the case of a number of corporations, employe groups or buying syndicates were formed, confident of their investments in their company. They proved that the employe who had invested

in his own company's stock and knew its soundness from observation, was immune from the "mob panic psychology" which so disastrously ruled the market.

It is evident that employe stock ownership is moving forward to new high levels, at a rapid pace. When the Pennsylvania Railroad alloted a block of shares for employe purchase in July 1929, the entire block was at once taken up by a total of 57,000 employes, who are paying for them at the rate of $2 or $5 a month, but permitting full payment within after a few months. This immense new employe ownership pushed up the total number of Pennsylvania Railroad shareholders to a new high record of 188,047, holding an average of 60.7 shares each, of par value of $50.

Employe stock ownership has passed an interesting and significant "fire test," not unscathed, but entirely uninjured in principle. It must be regarded as a permanent part of this age of the average man in share ownership and labor participation in industry.

Chapter X

What Does the Future Hold for Common Stocks?

HENRY CLEWS, the famous banker, tells in his recollections of fifty years in Wall Street, how the men who made the most money out of their investments, as he had observed, were the older, wiser men who were never seen *except when a panic was on.* Then, like spiders closing in upon a fly, they would buy good common stocks heavily and disappear again, certain of the fact that in a panic values were always far below their right valuation, and that the future of America being definitely upward, they knew their stocks would increase in value.

This is as sound doctrine as it ever was; indeed it is today sounder than ever, because we had a stock panic with a particularly big "dip," at a time when basic conditions are sound. The facts

in brief of the increased earnings of companies in recent years are very compelling. If you take 418 leading prosperous companies and examine their history for 1928,* you find that these companies had an increase of earnings applicable to common stocks of 20.5% over 1927; also an increase of cash dividends of 12.48%, and an increase of reserved earnings of 33.61%. This is a marvelous showing, of course, but it must strictly be kept in mind that these are selected companies.

If we take the nine months of 1929 prior to the stock panic, we find that 638 firms covering many industries increased their earnings 20.3% over the same period in 1928. 1929 dividends, as a whole, broke all records of previous years. Such figures offer full proof that hundreds of the firms where stocks are listed on the New York Stock Exchange, have had a very amazing growth in the last few years.

Let us look more closely at an individual example. A shareholder in 1925 of the American Can Co. has received in exchange for one share six shares, and the dividends and extras in November 1929 would make a return of $25.50 per original par value $100 share bought four or five years ago. Yet at the end of 1925 this

* Figures compiled by Ernst & Ernst.

original share was selling at 46, with a $2 dividend. American Can rode from this point all the way up to 184, and fell in the crash to 86, but of course has rebounded above that low point. Six times 86 is 516, which, even at panic-time bottom price, yielding 6%, is what the $46 share of 1925 transmuted itself into. As the undivided surplus is now about 65 millions, this factor is naturally reflected in the stock. Nevertheless the earnings are *more than four times* those of 1925. They have been put back into the business to the extent of 68% since 1919. American Can prospects are good because America is addicted to the tin can. In 1925 we ate only 25 cans per person, but in 1928 it had reached 31 cans and was still growing. The 1928 increase on the six main items of canned foods alone amounted to 235 million cans. Of course there is the negative side also—the new freezing processes and the increased popularity of glass containers may stop the rapidity of this rise; although, as in the case of the automobile, the canners are now developing a huge world market, and may go right on with their unusual ratio of growth.

I give this instance solely to make a realistic study of the foundations on which rest an expectation of future development in common stocks.

It is not at all an unusual picture of our large successful corporations, about 1,000 of which make more than four-fifths of the business profit of the United States. At Can's top price before the stock break in October-November 1929 it was selling at $184, which was 27 times earnings; and at its low price, 86, it was selling at 12 times earnings. It is certain of course to sell at a higher price, when one notes these basic factors.

The truth is that many of the factors which have been trending toward higher (but not inflated) prices for common stocks are still in action, more powerful and productive than ever, and in fact are permanent in their nature. Quickly resummarized, these are:

(1) Scientific research which is increasing the values, prospects and the market advantages which firms enjoy, and which is stimulating obsolescence.

(2) Increased good-will and productiveness of labor; increased use of power and automatic machinery and scientific management to reduce costs per unit.

(3) Sounder more closely knit organization and wiser executive management; and application of budgeting control.

(4) Greater sales and distribution economies attained through mergers, alliances, advertising,

research, analysis, cooperation, modernized sales policies, mass selling, lower prices, etc.

(5) Production standardization, simplification and elimination of waste.

(6) Improved competitive conditions through setting of better trade practice standards by co-operation and through Federal Trade Commission; more accurate records and knowledge of cost.

(7) The spread of wealth and increase of purchasing power; higher "real" wages, increased foreign trade; decreased purchasing power of dollar; prohibition, more stable markets and prices; perfection of credit system, elimination of frauds and fakes, cleansing of advertising pages; higher ethical standards.

These factors are like labor-saving machinery; their economy tends to multiply, and must even increase in future effectiveness. Each has as its ultimate aim greater certainty and greater profit for all concerned, and therefore functions as a lowering of the factor of risk in the common stocks of our leading companies, and thus a raiser of common stock values. A very powerful factor making for future common stock values is the recently announced reduction of corporation taxes, long a burden. A hundred million

dollars that went for taxes will now go into dividends, and push up common stock values.

There is no denying, however, that while the indicator is *upward* for the future of a limited number of companies, it is *downward* for a great many others. We are in a great general business era of consolidation; when large units for manufacturing and most other purposes are best fitted to survive. During the nine months' "boom" preceding the panic just about *as many stocks slid downward as went upward.* This fact was lost sight of in the over-weaning optimism of the day.

For the average man the common stocks of minor companies should positively be avoided, except a limited number which are in quite unusually strong positions. Their future is too much beclouded. So should be avoided the common stocks of certain industries which are lagging. The outlook for such *selected* companies and *selected* industries was never much brighter; but at the same time the need for watchfulness for the future was never greater because the tempo or "pace" of business is very fast. *Obsolescence is the order of the day;* "scrapping" is the matter-of-fact policy of both consumer and industry alike. What is prosperous this year may not be prosperous next year; one article is

displaced by another. This is quite as it should be in an increasingly scientific civilization. The more ready people are to throw out the old and install the new, the greater the stimulus to industry. This readiness to change or psychology of progress is most markedly on the increase; it is even acquiring the still more powerful stimulus of *style*. New goods of all kinds—even thermometers, caskets and machinery—is being bought not because it is any more efficient than the old, but because it is better looking, more artistic and pleasing, more luxurious, and with advantages of other kinds besides efficiency. The automobile is the shining example of this, and also of its effects upon the industry's prosperity, and upon the values of its common stocks. The increasing practice of "progressive obsolescence" is one of the most powerful leverages at work today for the future, because it is the tool by which we raise our standards of living.

As G. E. Roberts of the National City Bank, New York, says:

"It is a grave mistake to think that the great rise of stock values in recent years has been without any sound foundation, or has been due to mere speculative fervor. Despite exaggeration there has been a solid basis of achievement, as shown by the review of corporation earnings in

the first three-quarters of this year. During the past decade leading corporations, such as those whose stocks are listed on the New York Exchange, have gained very greatly in wealth and earning power. These stocks represent the leading industries of America. The companies are the survivors and exponents of the evolution and development in business methods which have been going on in this country over the last thirty years. They are the embodiment of what has been accomplished in proficiency and economy by the genius of invention and organization during this marvelous period."

Another test to apply is the figures of dividend payments. If one takes the dividend payments made in the first half of 1929 they reach the figure of 1¼ billions, or a gain of 15.9% over 1928. In 1925 dividend payments were only a little over half a billion. *They have thus considerably more than doubled in three years;* and 1929 dividends are certainly not dropping the pace; rather adding to it. Will they continue? Will the panic cut them? The answer is that the panic will certainly cut some of them, but will not affect others at all; notably the food, tobacco and industrial groups. Department store, apparel and luxury lines will feel the effects, and this will in turn slow up some branches

of manufacture. That is why we must look for a rather quiet 1930, although certainly there is no sign of a genuine depression.

It is the long-time view which I have chiefly in mind, however, the two and five year outlook. *This long-time view is very particularly good,* and two years from now stock prices at the levels prevailing during the winter of 1929-30 will seem incredibly cheap.

A careful examination of the factors entering into the situation—basic conditions, money cheapness, tax reduction, the work of the Hoover committees, building encouragement, public works developments, profits, etc., as well as the adverse factors of slump in luxury buying, lower and more uncertain automobile and steel orders, general check in confidence, etc.—leads me to set down as fairly reasonable and sure this time schedule:

January-May 1930.—Lull in business, particularly automobile, steel, building, upper levels of retail trading, slightly declining prices; with stocks marking time.

May-June 1930.—Upward turn in stocks, forecasting business recovery and new profits arising from increased building, automotive and steel outlooks, increase in foreign buying, encouragement in public works construction, etc.

August 1930.—Signs of a new "bull market," encouraged by "cheap money" conditions.

September-October 1930.—Strong confidence and increasing bull market pace; gains of last quarters of year bringing volume totals for year up to but not in excess of 1929 levels; although profits will fall slightly below 1929. Automobile production will, however, be lower in volume.

1931.—Unusual business records and full strength prosperity; strong upward trend in values.

The value of a common stock is nothing more nor less than everybody's guess at what the stock is going to be worth soon; worth not only in dividend return, but in general valuation based on the future prospects of the particular business and the industry as a whole.

There are two kinds of interest in common stocks; the short-time interest for the quick speculator and the long-time interest for the sound investor. I am not in this book paying any attention to the short-time speculator (who usually used borrowed funds). I am giving attention largely to the *long-time* investor in common stocks who desires to buy outright, preferably in five or ten share lots, which is the method I advocate for the average man or woman. Short-time speculation in common stocks by the aver-

age man or woman I do not advocate at all, and consider it distinctly unsafe and unsound, for reasons I explain in detail elsewhere.

Therefore, for the average man's long-time common stock investment purposes, the study of the future is all-important. Particularly important is the general business future, one year, three years, five years, ten years, even twenty-five years ahead.

As head of a business research organization which has analyzed business continuously for 22 years and surveyed separately in detail over 500 industries and lines of trade, I will make bold to give my own views, and then I will quote others.

Point I—*I am convinced that the prosperity possibilities (therefore the common stock business profit possibilities) of the United States have only been carried out to about 10% out of a possible 100%.* I base this—as it should be based—upon the amount of possible consumption of goods in the United States. Few people realize that only about 27,000,000 people out of a total of 120,000,000 people have an income as yet which permits them to buy more than about $200 worth more than the ordinary decent necessities of life. Nine millions of families still live on the Minimum Comfort Level; 6,390,000

families live on the Subsistence Level; 3,900,000 families live on the Bare Subsistence Level, and 1,900,000 families and individuals live on the Poverty Level. *This makes 78.6% of people who still live below the Comfortable Level,* (which has an income \$2,000 to \$3,000).* What will happen as we expand the wealth of the United States still further, as we are doing now with definite strides forward? The answer is, just what has happened since we moved forward from where we were in 1914—more buyers for factory goods, more income by our corporations, and a higher value for their common stocks.

My statement is further buttressed by the fact that surprising as it may seem to many, only 13% of families have electric washing machines, only 17% have vacuum cleaners, only 15% have even common ice refrigerators, let alone electrics. One could go down the line and point out the need existing for goods that would take many, many years to fill. We are in a twenty-year era of lifting up the living standards of our people, and each step forward in success in this will be reflected with a step forward *in the common stock values of the live, efficient companies.*

Point II—*I am convinced that the new and*

* From "Selling Mrs. Consumer" Chapter VIII, by Mrs. Christine Frederick, The Business Bourse, New York, publishers.

proved principle of enriching the consumer's dollar, through lower prices as well as high wages,—accomplished by increasing the production of workers through higher technical efficiency—is going to be spread further. At present only about 20% out of a possible 100% of American industry is operating on these principles. Corporation tax reports prove that 43% of our corporations make no profit at all, and another 25% make only narrow profits. Forty-five per cent of our factory equipment in America is admittedly *obsolete.* Here is a vast field for operations, and industry is learning more and more to operate at a more uniform efficiency. How many people realize that some blast furnaces require *eleven* hours of human labor to make a ton of pig iron, while another blast furnace, more efficient, requires only *one* hour? That in some shoe factories* the output is two pairs per worker per day, while in others more efficient it is *twelve* pairs per worker? That in some flour mills there is a production of 9,000 barrels per man per year, while in others the production rate is only 2,500? The interesting thing is that the poor producer pays the lowest wages.

We are already busy applying the new principle and increasing "real wages" or purchasing

* Statistics from the U. S. Department of Labor.

value of a day's labor. As we do this, gradually in the next twenty-five years, finding new kinds of employment for the men who are displaced by machinery, we will create more companies who are doing a good mass-production, mass-consumption job, and who therefore are building consumer good-will based on service and low price—*and whose common stocks will have higher value.*

Point III—*I am convinced that skill in management is increasing rapidly.* Every year we are increasing the number of corporations which are building wisely and entrenching their position through modern policies, wider distribution, lower prices, higher production per man, more consumer and labor good-will, more scientific research, less arbitrary, unscientific decisions,—and therefore more certainty of profits for common stockholders.

The old type of dictatorial management, incompetent banker control, family grip on executive positions; favoritism, old age let-down of aggressiveness, etc,—which definitely kept many firms from progressing, is now passing. Executives are chosen for proved executive ability and usually from the ranks. There is more careful study of management; more cooperation in passing executive knowledge from one firm to an-

other, more professional pride and organized technique in the standard functions of business. All this means a surer hand on the throttle, and therefore surer profits for the common stockholder.

Point IV—*I am convinced that the rapid progress of mergers and all cooperative action is not going to slacken, but even increase.* Periods of depression have always before quickened the merging processes. But we have been learning things about mergers and we will be more careful in using this tool. The merger is now more and more frequently of the vertical type (which includes all types of operation from the mine to the consumer, often including nowadays the retailer, chain store and the wholesaler), or the circular type (which tries to cut sales and distribution cost by manufacturing and selling various articles, such as breakfast food and mayonnaise and coffee, because they are all sold by one kind of distributor, who can be called upon by one salesman). Astounding combinations and alliances are being made along these lines, all tending powerfully toward economy, reduction of trade friction and competition. Industry is rather rapidly concentrating into stronger hands, abler management. We are going to have *still larger* mergers; *mergers of*

mergers; trade arrangements between banking groups, etc., all increasing the power and opportunity of the corporations which have good articles and strength with the public. There is plenty of capital for constructive business enterprises; the public is willing to participate.

At the same time we are having an increasing number of entire industries which meet with the Federal Trade Commission in "trade practice conferences" which set up standards of trade practice and ease off many of the costly frictions. This is a powerful profit lever also. This is an age of cooperation and large scale action—with profit for common stock owners as their direct fruit.

For these reasons, as above set forth, I look for an era of ten to twenty-five years of very remarkable increases in the values of *highly selected common stocks,* and good increases in sound common stocks that are listed on the New York Stock Exchange and on the New York Curb, and some that are listed on local exchanges.

Is my view too optimistic? Ignoring the views of anyone in the financial field, on the assumption that they are too close to the excitements of the day and the year, and remembering that we want very particularly a real long-time

view, let us ask Professor Irving Fisher, of Yale University. Says he: *

"We are living in an age of increasing prosperity and consequent increasing earning power of corporations and individuals. This is due in large measure to mass production and inventions such as the world never before has witnessed. Application of these inventions to industry means greatly enhanced earning power. This is a new and tremendously powerful factor in the industrial world and one which never before existed.

"Dividend returns on stocks are moving higher. This is not due to receding prices for stocks and will not be hastened by any "anticipated" crash, the possibility of which I fail to see. Dividend returns are increasing, due to rapidly increasing earnings.

"I believe more and more in the future. I know of a going concern whose stock is selling at $50 a share, yet earnings reported for the year just ended were only $1 a share. Many would say that the stock was selling entirely too high. I say it is selling too low. My reasons are that I know something of the inventions which the company has, the potential market for

* Written for *Boston Business,* organ of Boston Chamber of Commerce, October, 1929.

its products and the high caliber of its management. I know for a fact that at the end of another year the company will show earnings of $4, $5 or even $6 a share. Such earnings warrant the stock selling at $50 a share and even considerably higher.

"There are always a few in Wall Street who find out these things concerning stocks and run up the price of the stocks in anticipation of what earnings will soon become.

"The margin of safety between high-grade bonds and common stocks is rapidly being equalized both in actuality and in the popular mind. The future, I am convinced, will see this margin completely removed, with the result that common stocks will be regarded as decidedly safe forms of investment."

This is the word of a notably analytical, wise and unbiased man of high position, although he is definitely an optimist.

If we also inquire what the investment specialists think about the future of common stocks, we have at hand a conservative view in a technical book published recently * by Dwight G. Rose. After showing that the average annual appreciation in value of common stocks from 1901 to

* *A Scientific Approach to Investment Management* by Dwight C. Rose, Harper & Bros., page 179.

1928 was 7.8% (excluding cash dividends); that the average annual dividends were 5.4%, and that 6.5% was the amount re-invested by corporations back into their business, Mr. Rose says, "it would appear that industrial stocks could be purchased with confidence, in the continuance of this long-term upward trend so long as the industries supporting civilization move forwards; so long as the dividends represent a conservative portion of total earnings, and so long as the major part of excess earnings is not discounted in a greatly inflated market value." We see here sound prediction, for this was written before the panic.

The Committee on Trends of the Investment Banker's Association * expressed "unbounded faith in the continuing prosperity of the country, and while believing that the increase in stock

* In its annual report at the Quebec convention October 1929. This report also significantly pointed out that while we were a debtor nation (buying more goods abroad than we sold) it was in keeping with history that our conservative securities yielded a higher rate than they do now when we are a creditor nation. This is equivalent to saying that our lower yields of interest on common stocks today (because of their higher relative market price) is not to be regarded as a mark of inflation but as something that is to be expected now that the "balance of trade" is with us instead of against us, and now that there is greater stability and strength behind our business position. "Added to this," the report continues, "our efficiency and the promising growth of business, especially in public utilities, should give these stocks greater prospect of profitable growth than has been true in the case of foreign nations in the past."

prices would slow down, said *common stocks would seem destined to be accepted as a much more important form of investment than before the war.* In shaping our business policies we should recognize this fact."

Col. Leonard P. Ayres, financial economist, who so brilliantly forecast the "suicide of the bull market," is on record, since the panic, with a definite view of the future possibilities of common stocks. Says he:

"The good common stocks are today better investments than ever before. Corporations are bigger, better financed and better managed than ever before. After we get over this market situation, common stocks in the future will sell at higher price earnings ratios than they used to before the recent great bull market started. I think the public will still continue to prefer stocks to bonds as long-term investments."

BOOK TWO

Chapter XI

Should the Average Man "Speculate" or "Invest?"

IN this question is reflected the quandary of the average man. He is asking it constantly, and financial men are themselves puzzled and divided. One group believes in discouraging the average man from buying common stocks on credit, and others say he should be encouraged.

Who can really tell the difference between speculation and investment? It is, after all, a very slender line that divides them. What is the difference between buying some stocks on time payments, and buying them on margin? Both are bought on credit, hoping that they will rise in value. Every purchase one makes of anything is in a sense both a speculation and an investment; a theater ticket, a book or a new hat. Hope of gain is the motivation of all buying.

From this basic principle I build up my contention that the true balance for the average man is *investment-speculation*—that is, purchase outright. It is typical of the old-time attitude of rich men toward the average man, that he should worry about the average man's speculations. The rich man has always speculated freely, but solemnly warned the average man not to do so, and to put his money faithfully in the savings banks. The idea was that the rich man could afford to "speculate" but the average man couldn't. But the statistics prove that the rich man who speculated in common stocks grew richer, while the average man who invested in fixed income securities or in savings banks *became relatively poorer*. This is actually making the old Marxian doctrine of calamity come true! As I have shown elsewhere, the rich man's common stocks permitted his wealth to grow at the same rate of growth as the country, whereas the average man's fixed rate of interest actually pushed him backward, Einsteinly speaking! This was certainly not giving the average man his just deserts, nor his needful share of the risk of life. Red blood flows through the veins of the average man quite as pulsatingly as in the veins of the rich man. It is not surprising then that the average man simply won't

stand for it any longer. There are now figures available which show just how and why. The American Bankers Association figures show a decline in savings bank deposits and in number of depositors. The Savings Bank Association of the State of New York compiled some figures for the month of April 1929, as to withdrawals from savings accounts. In April 1924 there were 92 millions deposited but 102 millions withdrawn, or about a 10% loss in volume of savings. But this 10% loss seems small compared with the April 1929 loss: 143 millions in deposits and 170 millions withdrawn—a loss of about 19%. In other words, for every dollar people put into the savings bank in April 1929 they took out $1.19, and they have been taking out more than they put in for some years back. This is a steady development, not a mere boom year phenomenon.

The savings banks know for a certainty what people are doing with the money they are slowly draining out of their savings accounts. They are buying stocks—the savings banks say "speculation," but I like to be more accurate. Several large New York banks have been tracing the checks people give and in this way figuring out how much of the money taken from savings ac-

counts goes to different purposes. One bank found that 10% went for buying real estate or mortgage bonds, and 12% to stock or bond brokers. Another found that 23½% went directly for stocks or bonds, while a large proportion of 43% which was transferred to other banks was found on inquiry to go also for the purchase of stocks. Many savings bank men are very doleful about this, but real investment authorities, like Dr. Leland Rex Robinson, bluntly say that savings banks would do well to encourage their depositors to save money for the express purpose of buying good securities, and that savings banks should provide service to help them do so. There is a certain amount of injustice in the fact that an inexperienced timid investor who has $2,500 to $15,000 and keeps it in the savings bank is never told, except by doubtful stock salesmen, that he isn't getting "his money's worth" out of his savings. There is no reason in the world why such a timid investor should not be encouraged to own some diversified securities, with a fair proportion of common stocks in the package.

As a matter of fact many of the securities which the savings bank itself buys, according to law, with the timid investor's money, are dis-

tinctly "speculative." * The savings bank's deposits are actually not invested with the same flexibility and safety of a good investment trust, being limited very narrowly by law. The investment trust can actually pay 6½% to the average man, more safely than the savings bank can pay 4½%, and at the same time give the average man a fair chance for enhanced value, which the savings bank cannot offer at all. Is there any wonder, then, that the savings bank is more and more becoming the resort of the very shy and timid investor, rather than the typical, average man or woman who is "money-wise?" Just as we passed out of the "sock" stage of saving, or, for women, the bureau drawer or tea cup stage of saving, so we are passing out of the savings bank era into an adult era of more sophisticated understanding of how to make money work for you; one of the most important lessons possible to learn in modern life.

"Speculation" as such is not really what the average man and woman are doing, when they buy stocks outright, nor should they be charged with it just because the public has been a factor in the stock market collapse. Admittedly the num-

* Among those who hold this view are Don C. Wheaton, officer of Harris Forbes & Co., New York.

ber of ticker watchers and customer's room hangers-on has increased everywhere, but I am distinctly of the opinion that these are not the average man, but the well-to-do. The average man, to be frank, hasn't the time to give to speculation. If he tries it he soon discovers that he is at a disadvantage, and after having some of his savings nipped off by a frost, he becomes more "market-wise" and slips over the delicate dividing line between the speculator and the investor. Nor does this depend absolutely on whether or not he buys on margin. The average man, in these days of high margin requirements, does not get very far with "playing the market," true speculator style, for the excitement of the thing and the hope of "making a killing." Even to the extent many such average men get the speculative fever, it is often in some one particular stock about which they have constant information from close association, the stock of the corporation they work for, or one of their own town's or their own industry's leading firm. In such cases they are to some degree sophisticated specialists. Nevertheless my distinct advice to the average man is to be an *investment-speculator,* not a speculator. Speculation is a perfectly logical element of investment, but it should not be the tail that wags the dog!

There is no harm but great gain in the average man's purchase outright of stocks and taking a special interest in the speculative features of such a plan. It is certain that he is vastly more safe doing this than he was listening like a lamb to the lures of gold mines and other rainbow fake stock schemes for which his father before him "fell." The pages of history—especially in the railroad era of the seventies—are full of speculation folly infinitely worse than this—indulged in even by presidents in the White House and Supreme Court judges—all lambs led equally to the slaughter.

The average man's common sense in investments, I will venture to say, compares quite favorably today with those of the rich man. It is no secret that many of our bankers and big business men have a plentiful supply of "cats and dogs," and that the recent stock panic treated them roughly. Even J. Pierpont Morgan, the elder, had much stock that was more or less worthless when he died, and was known to consult astrologists about the market! His estate was far smaller than commonly supposed —below twenty millions.

That the average man, despite the stock panic, is fairly creditably investment wise is indicated by an investment trust. Out of 250 sales of

shares in New York City there were 78 sales of from one to ten shares; 130 sales of 11 to 50 shares and 31 sales of 51 to 100 shares. Here is proof that the bulk of the stock went to small investors. A large number of these sales were made to people who had never before bought stock of any kind; and about 46% of the investors were women. Here you see a revelation that is significant of the way in which the average man and woman are appreciating sound stock investment. You would suppose that the average man or woman wouldn't even know an "investment trust" from a handsaw. It is rather new—and has been in the public eye for only a few years. But here we see one share buyers, widows and school teachers using a new way of investing, (later on I discuss the investment trust fully). As one investment banker puts it, "prior to the Liberty Loan Campaign this country was a nation of economic and financial illiterates. People did not know a stock from a bond, and believed they were merely doing their country a good turn by buying the bonds, the finest security in the world. . . . It was predicted that we would become a nation of investors. Well, it has happened. There is nothing alarming in this situation, on the contrary we should

rejoice that so many people are learning how to take care of their money."

From all this I am ready to conclude that the average man and woman wish to be *both speculator-investor, rolled into one,* as they can be and should be. But there are distinct surplus levels and limitations beyond which the average man or woman becomes not a speculator-investor *combined,* but a speculator *alone.* I would define the true investor-speculator to be: A man or woman who has $2,500 or more in savings and who has a secure position and adequate wage or salary. If there is less than $1,000 the savings bank is an entirely right place for it. But the average man or woman, as soon as he or she has $2,500 has every right to hope to partake in the growth of the country—which is exactly what speculation in the positive sense means. (In the negative sense it means of course suffer with the decline of the country.) "Investment-speculation" may be in many different methods and degrees. Here is a table of investment-speculation limitations:

One dollar to $1,000—Absolutely no speculation, no chance-taking in any tiny degree. Nothing is too safe and sound for it. Use the savings bank or Government Postal Saving Stamps.

$1,000 to $2,500—The only chance or specula-

tion you should allow yourself is in the shares of a well-recommended investment trust, or good preferred stocks.

$2,500 to $5,000—Speculative percentage, 25%.

$5,000 to $10,000—Speculative percentage, 33⅓%.

$10,000 to $25,000—Speculative percentage, 40%.

$25,000 to $50,000—Speculative percentage, 50%.

$50,000 and upward—Speculative percentage, 66%.

By "speculative percentage" I mean the purchase of good common stocks, but with the intention of holding them for a long time. I have nothing to do in this book with "buy today—sell tomorrow" kind of speculation, on margin, which is ridiculous for the average man or woman, and out of place. There is no question but that buying on margin by the average man who has less than $10,000 is a tell-tale sign of absolute speculation, and as such unsound and dangerous.

The speculation comes in the uncertainty and risk of the stocks' future course. The true investor-speculator is the man or woman whose intention is to hold the stock for at least a year,

and more, and who buys not on "tips" or hunches, but on analytical fact, clearly reasoned out, based on information of an industrial or business nature, not a tip-sheet or broker's rumor. In other words on *logic* instead of on the throwing of the dice. The moment the average man or woman departs from being an investor-speculator combined, he is a fish out of water and sure to suffer. It is for this reason that I advocate the plan, fully described elsewhere, of buying in five or ten share lots *outright*, and only very occasionally, under certain circumstances, becoming a "margin trader." This advice applies to those who have from $2,500 all the way to $100,000 to invest.

The fundamental motive or principle that should always be behind the average man or woman is *investment*. Only the professional who equips himself and gives all his time to it is really sound in being primarily a speculator. We have an excellent example in W. C. Durant who is a speculator at heart, but who for years clung to business. They do not mix, and Mr. Durant's various business enterprises—beginning with the General Motors Corporation—failed to prosper genuinely until he put them in other hands than his own. Speculation is a perfectly respectable, valuable function, but it requires specialization

to a high degree. This the average man can never give, and therefore speculation, except as a natural accompaniment to his sound investment, is "out" for him, if he has any wisdom and common sense.

Chapter XII

Why I Favor the Five and Ten Share Outright Plan

THERE is a man I have known for many years. He makes a very good salary and he has a desire to lay aside a snug sum for the future. But for years he was very much in the habit of margin stock-speculation of the kind I do not approve of. He and a group of fellow-speculators would meet at lunch and exchange "tips," and each secured their "information" mostly by word of mouth from various sources, usually in the most casual manner, and rarely investigated. My friend was always very jovial and boastful when he had luck in the stock market, but silent and sometimes glum when he lost money. He was one of those many men who spread the glad tidings when they make money in the market, but never tell how often they lose!

My friend was an invariable margin trader. One day (and this was before the panic), in a genuinely confidential talk, he admitted to me that he was not much better off than he was four years before. Honestly and squarely facing his own records of losses and gains, from his "in-and-out" of the market policy of frequent buying and selling, he had to admit that the losses were almost equal to his gains. Of course this meant, when all the items of cost were considered, that he was standing still, and that the panic played havoc with him. When you consider the time and energy he gave to the "game," his record really meant a loss, even without the panic risk, which cost him five years' savings.

"You'd have been better off, and never run any dangerous risk," I told him with a grin, "if you had put your money in the savings bank!"

My friend winced. My words hurt, because he knew that I had often heard him argue warmly at the silliness of keeping your money in the savings bank.

"What do you figure out of it?" he suddenly asked, belligerently; "what's your system? Do you mean to tell me that a good business man like me should stay out of the stock market, and let all the big fellows make the money?"

"You forget," I replied "that several years ago I told you what my more conservative plan is, which has brought me out ahead of you. *It's the five and ten share outright plan;* pick your stock carefully on real analysis, and then buy five or ten shares of it outright, and *lay it away and forget it.* I know that you, who have dealt on margin, in hundred share lots, rather consider such a plan a 'piker' method. You like to think that every time the stock moves up a point you're in a hundred dollars, instead of ten. But here are my reasons why you are wrong:

"Point one: I do not believe in margin trading on a hundred share basis for any but wealthy men. That is the rich man's standard; and I notice that not a few rich men are given to buying outright, even so. Your lead pencil will tell you that a man like you who has a surplus of only about $5,000 to a year to invest is putting too many eggs in one basket to deal in hundred share lots on margin. You have narrowed yourself too dangerously.

"Point two: You are a business man with an exacting job. You can't give the time to speculation as such, on an in-and-out of the market basis. It requires too close watching; too constant attention. Bigger men than you have tried

it, and either failed at their jobs or at their speculation. You are foolish to try to be a speculator; you should aim to be *an investor-speculator*."

"What's that?" my friend asked.

"It's simply a man who keeps clearly in his mind while buying stocks that he is first of all an investor, and only secondarily a speculator. If you had the right qualities and resigned your job and opened an office downtown as a speculator, that would be fine. Speculation is an honest, serious technical business, useful to business and finance because it helps keep the values of stocks accurately adjusted to conditions. But you haven't the temperament nor the technique for being a speculator. What you've been is *a playboy;* you've played the market for the excitement of the thing, as men play poker. Some men can afford that sort of thing, but you can't; the proof is right here in your little black book.

"Now let's make a little calculation. Let's take the first ten stocks you bought four years ago and let us suppose that you had bought outright at that time ten shares each, *and held them*—instead of buying in 100 share lots on margin, and aiming to sell after a little rise."

I saw a sheepish grin appear over my friend's face, and when I took his little black book in my hands to make the calculation, I soon saw why.

Among the first ten stocks was listed Montgomery Ward & Co. stock, bought at 66. (It had gone up to over 400 since then, I knew.) But keeping my face straight, I worked with my pencil on the back of the menu card on the lunch table, consulting the morning newspaper for the latest quotations (pre-panic).

"Here you are," I said, after a while. "Instead of just barely coming out even, as you now stand, the five and ten share plan—even if you had stopped buying any more stocks after the first year—would have returned you the magnificent profit of $7,140, on an investment of $6,200. What do you say to that?"

My friend squirmed. "But that Montgomery Ward stock was exceptional, and I had the bad luck to get an awful licking on that Brown stock," he protested.

"You're like all these stock play-boys" I told my friend. "You're always talking in terms of *luck*. The truth is you were just gambling instead of using the business judgment you have. You sold your Montgomery Ward stock at 82 because you were working a speculator's method of selling at about a ten-point rise, whereas you aren't a genuine speculator and never will be. You're just one of the lambs that get shorn. If you had worked true to your genuine, ap-

propriate character *as an investment-speculator,* there would have been no reason why you should sell that Montgomery Ward stock, and you'd have gone about your business and forgotten about it."

My friend was rather impressed. The facts were too bold and staring, right in his own little black book. He grudgingly admitted that I might be right. Now, after the panic, plus the lesson I had given him, he has become one of the most enthusiastic operators of the five and ten share outright plan.

"I'm not quite so important a man in my broker's office anymore," he laughingly told me recently, "but my wife thinks I've at last become a responsible citizen. You can imagine that she was not not very well pleased with me when I dropped five years' savings in those first two big panic breaks. I made my resolve then to drop margin trading. Now she likes to see and feel the stock certificates, and watch the dividend checks come in. I'll admit it's a good system. I'm going to stick to it."

It isn't a "system," but any man is wise to stick to the plan. Even if I were a bootblack, or a railway hand with some savings, I'd buy *one* share at a time, outright. But the varying prices of common stock shares of merit make it

possible for anyone with savings to buy five shares at a time. Five shares of a stock selling at 28 costs only $140; at 60 five shares cost only $300. This is within the reach of anyone who saves. Yet five shares of American Tel. & Tel. stock, selling at 210 at the moment of writing, is $1,050, which makes it a sizeable item of purchase for almost anyone. The price of the stock has nothing to do with its prospects; the prices are fixed by the financial set-up of the particular stock. Most corporations today split up their stock when it reaches a figure making it discouraging to the ordinary buyer, creating two shares out of one.

The habitual operation of the five and ten share outright buying plan has many other merits than those I have discussed. It is more definitely in keeping with the investor-speculator idea, because *ownership is the genuine earmark of investment.* You buy the speculative element with it, since common stocks—or bonds, too, for that matter—are always a speculation anyhow. Outright purchase discourages you from being a mere opportunist and lifting the telephone receiver to sell it after having made a few dollars on it, and thus makes you a *long-time* speculator rather than a short-time speculator. The point is that the average man has much better

hope of profit if he keeps to his true character of investor-speculator on a *"long-pull" basis.*

At the same time he is enabled, by the modesty of each particular investment, to properly diversify and scatter his investments, and thus achieve greater safety. The more of these five and ten share lots he has in his possession the more fields of industry he can cover and the less easily he will be caught by depressions or upsets, as business is rarely bad in all lines at once. By intelligently picking the industries he goes into, and staying out of the more chancy ones, he will greatly reduce his risks.

At one time there was some difficulty in buying in five and ten share lots, but that was in the days when the wealthy were the only traders. Today there are plenty of facilities for outright purchase in these amounts.

Once every three months the owner of five and ten share lots should check over his holdings, and re-analyze briefly the stocks—using the "measuring stick" described in Chapter XIV. He should not sell just to make the profit that has accumulated. He should sell only if the stock appears to have reached an inflated status; but he should be very wary about selling at all unless the particular industry as a whole is declining, or the management obviously bad. If the industry as

a whole is rising, and the sales of his company are also rising, he will be very foolish to sell.

There will be those who will feel that the "excitement" of stock market dabbling (something they frankly relish) will be lost if they became outright buyers. Let me say to such that they are actually wrong. There is a bigger game to play in the five and ten share outright method, a difference that is like the difference between playing "craps" and playing chess. That difference lies satisfyingly in the use of more intelligence and strategy, and therefore something which is more *genuinely* interesting. What is more, it is a smaller counterpart of the same kind of method used by the much larger market operators, men like E. H. Harriman, or Frank Munsey; men who did not pretend for a moment to be professional speculators, but bought stocks outright on a basis of an analysis of values and long-time holding.

The long-time investment-speculator point of view is, I insist, the only genuinely sound point of view that the average man (which includes the average well-to-do business man) should at all consider. I discuss elsewhere the special circumstances under which I regard margin trading sound. The long-time point of view is, as a matter of fact the soundest one *for any venture in*

which speculation enters. One has only to look at the Astor and other New York real estate fortunes to see the amazingly fruitful results of a long-time point of view. It is easy to imagine the Astors being approached half a century ago and told they were crazy to hang on to their land. "Sell at once and make a million!" many people doubtless told them. But they preferred to wait still longer and make a hundred million! James J. Hill taking the long-time point of view about the Northwest; Commodore Vanderbilt taking the long-time view of the middle west —these are now classics of business wisdom, including Ford's and W. C. Durant's long-time view of the motor industry. It is the small and petty trader who is always in a hurry to sell and scalp a few dollars on a short vision. The conspicuously rich men have never acted that way. Imagine the scorn old George F. Baker would have shown at the idea of selling his U. S. Steel Corporation stock when it touched 100 and offered him 8 or 9 times his purchase price. If the detailed story were told of the rich men who still own the common stock they had twenty-five years ago—and are wealthy because they do—it would make marvelous, Aladdin-like reading.

Why should the average man follow the silly crowd of sheep fluttering like race-track gam-

blers over the tickers and quotation lists from day to day? Why should he not follow, instead, the example of the wisest men of wealth and salt away the actual stock certificates? That is investment-speculation with the punch of reality behind it—and a square chance for sound profit.

The Twelve Test Principles of Successful Common Stock Buying

THE "measuring stick" which I present in the next chapter for analyzing common stocks, is a *statistical* measuring stick for application to a particular stock. Before this can be applied intelligently, there should first be used a *general* measuring stick, far less specific or "scientific," but nevertheless most vital. It represents all the arts and wisdoms of well-seasoned investment judgment, "fire-hardened" by many a panic and depression, and hammered into a fairly tough and reliable standard by the combination of the experience and judgment of many men of many temperaments, both over-cautious and over-optimistic. I have searched far and wide before making up these twelve principles, and consulted many people. I did not trust any

individual's principles, no matter how successful that individual's investment record was. I wanted to make *a synthesis* of the best judgment, as guidance for the average man or woman. I do not aim to make these principles too "safe," for if I did they would not be genuine guidance for an *investor-speculator,* but only for investors. Anyone can give 100% "safe" advice to an investor in a few words; the more difficult task is to offer helpful guidance to an investor-speculator.

Here, then are the Twelve Test Principles:

One: in regard to money that you are thinking of investing in common stocks. It must *not* be money which is vital and necessary to your business or your personal and family operating needs. It must, in no case, be money which would be disastrous to lose; or money entrusted to your care; it must, in other words, represent genuine investment-speculation surplus, and even so should be only a limited portion of this. (For suggested proportions, see Chapter XI.)

Two: in regard to the processes of your mind in choosing common stocks. You should insulate yourself absolutely from all "crowd psychology" or "follow-the-sheep" feeling, and from all "impulses," "hunches" and hearsays which would tend to make you act without reason and analysis.

Three: in regard to the limitations you should

impose on your scope of buying. You should firmly restrict yourself from buying any common stocks whatsoever which are not listed on the New York Stock Exchange. If you are a business executive, I should say that you could also include the New York Curb market, or the local stock Exchange of your city, *but not otherwise.* You should still further impose this limitation: that you will buy only the common stocks of leading companies in industries which are firmly grounded. (This would, for instance, have saved you from investing in radio or aviation stocks during the earlier unsettled and dangerous period of these industries.)

Four: in regard to the method of buying you will pursue. You should firmly remove from your mind the idea of *margin trading,* and operate the *five and ten share outright* plan fully described elsewhere. While it is true that I point out permissible exceptions to this rule in another chapter, in making a general rule I must insist that this is absolutely the consensus of wisdom. Credit buying of stocks is possible in other ways than margin trading, for the average man. There is no lack of interest, profit or even of excitement in trading on this basis.

Five: in regard to the time factor in buying or selling. The absolutely correct time to buy

common stocks is when the entire list of stocks is as near as possible to the bottom of the long swing or recession or panic. Or else when the clearly discernable future values of a particular stock have not yet been reflected in the market price; when it is selling definitely below its proper valuation. To advise anybody to buy at "panic-time" is of course one of the oldest (and best) recipes for success. Many of the most famous professional "operators" and wealthy men have done this. The great law underlying this is: the best time in the world to sell anything is when the desire to buy is strongest, because that is when the highest value will be placed upon it. On the contrary, naturally, that is the poorest time to buy. Also, the time when values are at a low peak is naturally the poorest time to sell.

This *sounds* simple, but the difficulty is of course to properly judge when values are at a very high or very low peak. In the past two or three years—according to the theory of a "new era" being here—nearly everybody has been rather confused about this, although there are some more or less certain guides, such as when the average yield on stocks is lower than the current rates of interest; and when the market price-times-earnings for most stocks is considerably above that of conservative "pilot stocks"

such as U. S. Steel. *But during the winter of 1929-30, following the panic, there is no question but that a real "bottom" has arrived.*

Six: in regard to the spreading of your risks. You should be aware always that the speculative element in your investor-speculator operations must be taken in hand and barricaded against the hurricanes of swift market change. *Diversification* is the shoring timber with which this is done. To diversify means *to spread your common stock investments into different fields. Every investor-speculator in common stocks should be in at least five different lines.* An ideal combination is as follows:

(1) railways
(2) manufacturing
(3) retail
(4) mining or oil
(5) machinery or equipment or accessories or public utilities

The investor who is able to acquire quite a long list of common stocks would do very well to aim, eventually, to cover all or nearly all of the subdivisions which are listed in Chapter XVI as classifications for stocks of all kinds. Note that there is even *foreign* stock listed there. We are now a great international investing country, and it is a very good idea to include foreign securities.

The sun is always shining somewhere in the world, even when it is dark in America!

Another point about the spreading of risk: not only should the number of shares you own be divided among various industries; but also *the dollar volume.* For instance, it would *apparently* but not actually be obeying my rule to own ten shares each in four different industries whose stocks were selling at 20 or 30 per share, and ten shares in say American Tel. and Tel. which sells at nearly 210. Thus the 40 shares would represent a total of only about $1,000 invested in four industries, whereas $2,100, or 66% of the total capital, would be in *one* basket! This would not *really* be spreading your risk.

Seven: in regard to holding and selling. Aim to be a long pull investor-speculator, not a nervous, catch-penny, gambling in-and-out trader or customer's room chair-warmer and tape-reader. Many searching investigations and frank confessions have revealed that there is little or no money in this type of buying and selling, *even by professionals;* and the average man is at a distinct disadvantage in such a business.

Have the courage not to sell, unless there is the most obvious reason for it, due to the facts as to the stock's likelihood of decline. Do not sell because you have had "profit enough." Re-

member your primary character is that of an investor, not a speculator. Many a man lives today who never looks at present-day quotations of U. S. Steel, Montgomery Ward, General Motors or Woolworth without a pang—because he recalls that he was fool enough to sell his holdings at a profit far below today's quotations.

Eight: in regard to courage, decision, balance and poise. You will be surprised how men's basic character qualities tend to shine forth in their investment dealings. It is a fact that most of the instances of great success and failure in investment are directly traceable to character qualities; to too much optimism or pessimism; to too unstable a temperament, too much indecision, lack of courage or balance, and too great a lack of poise under fire. It takes courage even to make a decision to buy a particular stock with one's savings. It takes poise to sit tight while the market heaves and turns turtle, until it rights itself, and still more if it does *not* right itself but punishes you severely. It takes balance to keep your eyes upon the *aggregate* gain, and not get too puffed up or too downcast about one individual ten-strike, or one individual loss. The *law of averages* should be your staff and comforter. Indecision and over-caution are quite as fatal as bumptious over-confidence. You must expect to

make errors and to pay for errors; without losing confidence in yourself.

Nine: in regard to the strategy of your funds. You should never buy at one time all the stocks you intend to buy, nor invest your entire allotment of common stock funds. You should at all times hold yourself in a "liquid" position, with reserves, to take advantage of emergencies, special situations and declines. If you have invested all your funds in common stocks and the market breaks to its low peak, you are cornered very disadvantageously. You cannot sell without loss, and yet there are splendid bargains to be had; you are missing your opportunity. If you had practiced the strategy I advocate you would have a reserve of about 25% of your total common stock investment funds, either in the bank or in bonds—preferably short-term bonds—which would not be much affected by market declines and still be quickly convertible into cash for taking advantage of bargains. It is even more ingenious strategy to have *two* lines of reserves (1) short-term bonds, and (2) your accumulating bank funds, creditable to your investing account.

Ten: in regard to the annual housecleaning of your holdings. You should not let the putting away of securities purchased outright become a fault instead of a virtue. Much bad investment

management is chargeable to this. Certainly once a year you should spring-houseclean your holdings. Get them out and study each one anew; this time in relation to the whole general structure of your holdings. Check them (1) for deadwood, to be sold and reinvested, whatever loss may be involved; (2) for diversification; (3) for exchange for something better if they seem dubious or static; (4) for general standing.

Eleven: in regard to sources of information and guidance. Naturally you must have sources of information, and repose your confidence somewhere, to some degree: But make it an absolute principle never to trust implicitly anyone's opinion about stocks, no matter whose it may be. In particular do not take the advice of brokers or tipsters or casual hearsay. *Doubt your best friend.* Subject everything to the cold test of your own analytical reasoning, the figures and the "measuring stick." Do not, especially, be stampeded by enthusiasm or circumstantial rumors or "facts." Judge shrewdly the general situation by striking a balance between all views. Keep your eyes open and read much about the general progress and condition of business and industry, so that you will get "the feel" of its motion and direction. Trust best of all your own logical processes worked out from what you piece

together from the pattern of events and conditions. The major developments in common stocks are surprisingly consistent, and often rather obvious. Thus the oncoming industrialization of the south was certain to boom southern railway stocks; but it took a long time for people to put two and two together. Even the stock panic was predictable from the vast increase in new stock flotation, to mention only one thing. Think fundamentally about basic conditions, not on the surface about daily inconsequential events. Cultivate personal contacts with men who have mastered business and finance, and in particular contact with and employ an investment banker—not a salesman—who is not only capable and efficient, and whom you have investigated, but who will take a friendly personal interest in what you are doing and who will freely answer questions you raise.

Twelve: in regard to the ultimate safeguarding of investment. Anchor your funds securely by keeping 25% of your money invested in bonds. This is entirely aside from any funds you may keep in bonds for the purpose of quick liquidation to buy common stocks. *At all times* 25% of your surplus should be in bonds; I recommend short-term bonds. Bond values have a useful reverse relationship to stock values; when

bonds are low in price stocks are high as a rule, and when stocks are high bonds are low. Bonds form one substantial foundation on which to build a fortune; even though the proportion properly investable in bonds has shrunk in recent years. One quarter of your surplus in bonds is entirely sound in these days when common stocks have greater security value. Check your surplus yearly, and figure the quota that should be put into bonds. Hold to the 75-25 ratio; you will not regret it. If your general situation advises more conservatism make the ratio 66-34.

These, then are the Twelve Test Principles of successful investment-speculation. They are without question solid and effective, and also modern and liberal, and defy attack. Steer by them, and you should profit adventurously but still keep your feet on solid earth.

Chapter XIV

A Definite "Measuring Stick" for Judging Common Stocks

FOR the average man and woman who insist upon using their own brains in buying stocks, and who want to be as intelligent about it as possible, there must be given a method of logical analysis in tabloid form. It is preposterous folly to expect such people to read ponderous books on "scientific investing" using the language of the investment specialist which even rich investors do not understand. They simply won't read them. Even capable business executives, used to the language of business, cannot digest them.

Yet such average men and women really need and want some guidance, if they are to be *investor*-speculators, and not *speculator*-investors. They need to be given a highly simplified meas-

uring stick for valuing stocks; one which will frankly eliminate most of the "buts" and "ifs" and "whereases" of the technical investment man. The logical justification for this lies in the fact that after all the fortunes of most common stocks swing upon very simple fundamentals, and not on a highly complicated scale of values. The rich man is exceptional who delves into many tiny details of a stock; he is usually an able business man himself, with a sure instinct for the fundamentals.

If therefore we can give the average man and woman the basis of applying these fundamentals, and induce them to use it invariably before buying, on a mathematically graded scale of values, we have surely gone a long way toward making common stock investments safer and sounder for the average person. Far too much common stock selection—both by rich men and by average men and women—is still by word-of-mouth "tip" or by following somebody else's example, or by some other "hunch" method. Even the recommendations of reputable investment advisory concerns and periodicals, excellent as they have been, would lose nothing in value if each person intending to follow them, still used a definite scale of values for judging all purchases, however suggested or by whom.

Is such a definite scale of values possible or practical?

I believe it is, for I have devised one and have used it with success. I have the backing * of so eminent an authority on stocks as Dow, Jones & Co., publishers of the *Wall Street Journal* and operators of the leading electric news ticker, in my statement that such a measuring stick is entirely feasible and practical, and in the manner of doing it.

The Investment Bankers' Association of America has gone on record in its latest report, as to what constitutes a fair measuring stick, in spite of the fact that it believes there is no "simple rule." It says:

> "The value to be placed upon a common stock is a matter of judgment based upon numerous considerations. Asset value is not of major importance. Consequently much attention must be given to management, to the nature of the business, its stability and possibilities of growth. This involves competition and potential competition, the percentage of earnings on invested capital, and on the gross business. It is here that the asset value has its real bearing. Of great importance is the relative value of the stocks of other companies in the

* In a letter to the author, J. A. Baldwin of the Inquiry Dept. says "True, the establishment of any measuring stick must be arbitrary. We would suggest arbitrarily compiling a small chart with so many points for management, so many points for ratio of common stock to funded debt, etc."

same and similar lines of business. There must be considered also the extent to which the stock is held by investors and the relative size of the so-called 'floating supply.'

"No sound judgment of the value of common stock can be reached without taking into consideration general business conditions and prospects and general market conditions and prospects, all of which naturally involves present and prospective money conditions. Relative values are essential in valuing any common stock.

"Of increasing importance in valuing common stocks is the income yield. The more widespread the interest in common stocks and the more numerous the investors in this class of securities the more important this becomes. When persons of large means were the principal investors in common stocks and those of small means were not greatly interested in stocks for investment, income was not an essential factor. With the greater investment interest income will become of more and more importance."

I have sought the opinion and suggestion of many authorities before constructing my "measuring stick," and I do not believe that there are any serious flaws in it. Quite obviously the yardstick has defects. It cannot be applied alike to an industrial stock, to a utility company, to a bank or to a railroad; the businesses are too dissimilar. Therefore I chose to construct my measuring stick for industrial stocks primarily,

although it will have some usefulness also for other types of securities. It is a great step forward in the elimination of the gambling spirit and unnecessary risk when the investor will consent to apply his brain and his common sense to *any* method of measurement or grading. It was an epochal step forward when Moody's and other investment services roughly *graded* stocks in their bulletins. We now have half a dozen sources of data which use the letters of the alphabet, A, B, C, D, etc. to classify the standing of stocks and bonds.

But these are ready-made gradings, often six months to a year old, and have not the same value as one made by the investor himself, with the latest information. They are excellent to supplement and check the investor's own analysis, but nothing can be so vitally, educationally important as the critical examination by the investor himself. The best profits in common stocks are the result of a definite reasoning process, starting with a group of facts and arriving by logical steps to a definite, *measured* conclusion. This is the true scientific spirit, and in my opinion the hundreds of thousands of average men and women who now buy stocks, will never change from dabblers and gamblers into investment speculators, using their cash and credit wisely,

until they begin to use even so simple a measuring stick as this. If we insist that investment is too "complicated" for the average man to grasp, and that he cannot measure common stocks for himself, he will simply continue to buy on "hunches" and "tips" without using much reason and analysis, and the danger from wide public speculation will increase rather than diminish. If we are to have "a nation of investors" —and it looks as if this will become more and more the fact every year—we will surely have a repetition of the old boom-depression ups and downs until we teach the average investor as a class—just as business men were taught as a class—to operate to a greater extent on information and analyzed measure. Mere "warnings" at banker's conventions won't do it, but simplified suggestions for analysis will do it.

This is precisely what my exceedingly simple measuring stick provides. It does not require information or judgment that is unobtainable by the average man or woman, and it does not take a mathematical statistical training beyond the average. If it leaves out much, it also includes much; if it leaves much to the average man's own judgment, it at the same time introduces *a measure* for judgment; and it does concentrate upon fundamentals. Its conscientious

use will sift out automatically most of the over-valued, dangerously inflated stocks, and the stocks which are in a very weak basic position. It cannot be regarded as infallible of course, and must always be applied, like any other measure, with common sense and reasoning, and not a mere "rule o' thumb."

The "measuring stick" consists of making use of the scales shown in the accompanying diagram. To operate it, assemble all the information required that is possible to obtain, and then deliberate over each factor, one at a time, giving the stock a percentage rating on each af the ten points, after considering all the facts pertinent to that one factor, and making a judgment expressed in figures from 1 to 10. Then, when all the ten factors have been separately marked, with a rating, add up the total, and you will have, in percentage form, a general rating of the stock.

No stock which does not grade 70% on this scale should be purchased.

The marking plan of this "measuring stick" should be explained, if it is not obvious from the diagram.

You will see *two* scales of figures alongside of each one of the ten factors. The one on the *top* is the one which furnishes the total, after you have made your marking. *It differs for every one of*

the ten factors, because, of course each of these ten factors have a varying degree of importance. *Industry Status,* for instance, is more important than *Dividends-Income Yield.* It if were not for this scale of differences we would make the mistake of supposing that each one of the ten factors had precisely the same importance as the others. Of course they have not; therefore it was necessary to set up a *varying* scale of value, as indicated by the figures at the top.

The figures *below* the top ones, however, are *identical*—each on a scale from 1 to 10, because this makes it simpler to calculate. When, for instance, you set out to judge a stock on Factor No. 1—*Industry Status*—you *ignore the figures on the top line altogether,* and put your pencil check-mark at any point from 1 to 10; ten being perfect and zero being very bad; five being medium. *After* you have placed your check-marks for all the ten factors, *then* you pay attention to the figures on the *top. You then note what number on the top line of figures your check-mark touches most nearly.* Write it at right-hand end of the line. When this is done for each of the ten factors, you add up your column, and you have a total percentage figure which very accurately epitomizes, on a measured

scale, your combined judgment and the facts about this particular stock.

Form the habit of doing this for each stock you think of purchasing—or even at intervals for those you have already purchased. A small supply of these analysis charts are provided with each copy of this book; additional quantities may be had at small cost from the publishers.

I will now give some detail as to the considerations which should go into the making of a judgment of each factor.

1. Industry Status—As described elsewhere in this book, the position of the industry *as a whole* is vital to the possibilities of any one company in that industry. In Chapter XXII there is provided a separate analysis, with ratings, for each of the major industries. This is a starting point; and any industry which belongs to any one of these major groups probably partakes of the same status—although there are plenty of cases (as in the case of anthracite and bituminous coal) where one section of the industry is dull and the other lively. The six ratings employed in Chapter XXII, comprised of one, two and three stars, and one, two, and three X's, are calculable on the scale of 1 to 10 by rating one star at 9, two stars at 7 and three stars at 5; one X at 4, two XX's at 2 and three XXX's at 0.

Current data about the industry in general is to be had from the sources of information recommended in Chapter XVI, and if these should not be sufficient or clear, *trade papers* in the industry in question should be looked up, or special information called for from statistical sources.

2. Management—This is an exceedingly important, but also an exceedingly difficult thing to measure. There is no ready mathematical measure to be had. Even earnings may not be a genuine indicator of good management, although they are an "acid test," especially if they keep up during hard times; but earnings are not to be considered in making this judgment. As Dow, Jones & Co. put it in a letter to me: "management is the most important factor. For instance, take two companies in the same field. Let one be rich in working capital, without funded debt and have a good sales organization, *but poor management*. Take another company with good management, *no* working capital, heavy funded debt and poor distributing organization. In time, with ordinary business the poor management might ruin the company looking so well on paper, while good management might enrich the company that looked poor on paper, and retire its funded debt, pile up a surplus and pay big dividends."

How can good management be measured? There are four kinds of management:

(1) *Production management* (which can be judged by the quality, value-at-the price, popularity and adaptability to the market of the goods made by the company).

(2) *Sales management* (which can be judged by the rapidity with which sales volume is rising, and maintained, and its volume; also its ratio of profits to sales, and sales cost, if ascertainable. Its *advertising* also tells much).

(3) *Executive management* (which can be judged by the general status of the company in its field, and its reputation as a whole, and that of its executives individually, if they are known. It can also be judged by the general up-to-dateness of the company's policies, by its good-will, and by its research methods, modernness of equipment and methods).

(4) *Financial management* (which can be judged by its figures and their showing *as a whole.* Specific aspects of its financial management are of course rated elsewhere).

3. Ratio of Earnings to Price—This factor has been discussed in much detail in Chapters IV and V. Arbitrarily we will assume that a ratio of 12 is worth a rating of 5 on this scale; a ratio of 15 is to be rated at 3 on this scale and a ratio

of 20 to be rated at 1. A ratio of 10 is to be rated 7 on this scale, and a ratio of 8 is to be rated at 9. Any ratio below 8 is to be rated at 10.

It is an exceedingly simple thing to figure out the earnings-to-price ratio. Take the latest figure of earnings per common stock share for a full year (Moody's Manual or the *Financial World's* "Independent Appraisals of Listed Stocks," or other sources will provide it) *and divide this figure into the latest market price* as given in the newspapers. This gives you the ratio at once.

4. Earnings Trend—This is a simple calculation. Get the five year record of earnings, per common share, or total volume of earnings, per year, and *chart them,* on a simple mathematical graphic chart, with a pencil. This will give you *a trend line*—up or down. You can also get a more closely current trend line by using the *quarterly* earnings figures, if available, and see how the trend is for the year; noting the standard seasonal fluctuations, and comparing with other years.

5. Financial Strength—This is a matter entirely of figures. *Surplus,* or undivided profits, is the first main item to consider. Companies having large surpluses which they have wisely invested, offer the stockholder a *double value;*

(1) from sales operations, and (2) from returns on investments. They are virtually investment trusts. *Ratio of common stock to funded debt,* should next be considered; as indicating how much "in hock" the company is. Next is *ratio of net working capital to sales,* indicating how well financed are the current sales operations. Next is *ratio of profit to net working capital,* indicating how good a return on capital invested is being made. Next, is *asset value.*

These are simple sums in division, if the figures are provided by the companies, as they are in a great many instances in annual statements and balance sheets. If such figures are not available, make the best judgment possible from the figures provided, keeping a maximum of skepticism for companies which do not provide them.

6. Leadership—If possible, get the figures as to the rank of the particular company in the industry. Is it first, second, third, or twentieth in point of volume of sales? Are its sales growing the fastest, or are the sales growing less rapidly than those of a company which has less volume? Watch this point, as young or abler competitors may be making it very hot for the company.

Next, settle in your mind how the company ranks *in the minds of its consumers.* It may be

tenth in volume, but first in the regard of customers because of its progressiveness.

Next, look into the company's *technical* leadership; its research policies, modern point of view, policies of creative progress in the industry, etc. After making all these inquiries or judgments, take them all into account, as a whole, and rate the firm.

7. *Prospects*—Consider here first the general prospects of the industry as a whole. Is it a young, growing, live industry, filling a strong and permanent need? Or is it an old industry, with many barnacles, a declining interest on the part of customers, or a serious condition of obsolescence, meaning gradual displacement by more interesting or efficient goods?

Then consider whether the company is producing something unusual which is in the first high curve of appreciation and use; or whether it is producing an old or unimproved article, or one on the falling curve of popularity or saleability. Consider whether new developments, new research, new advantages, higher quality, lower costs, higher prices, new outlets or new connections and affiliations are making far better prospects. Or the *reverse* of all this. Consider prospects of competition, or lack of competition —*from both inside and outside the industry.*

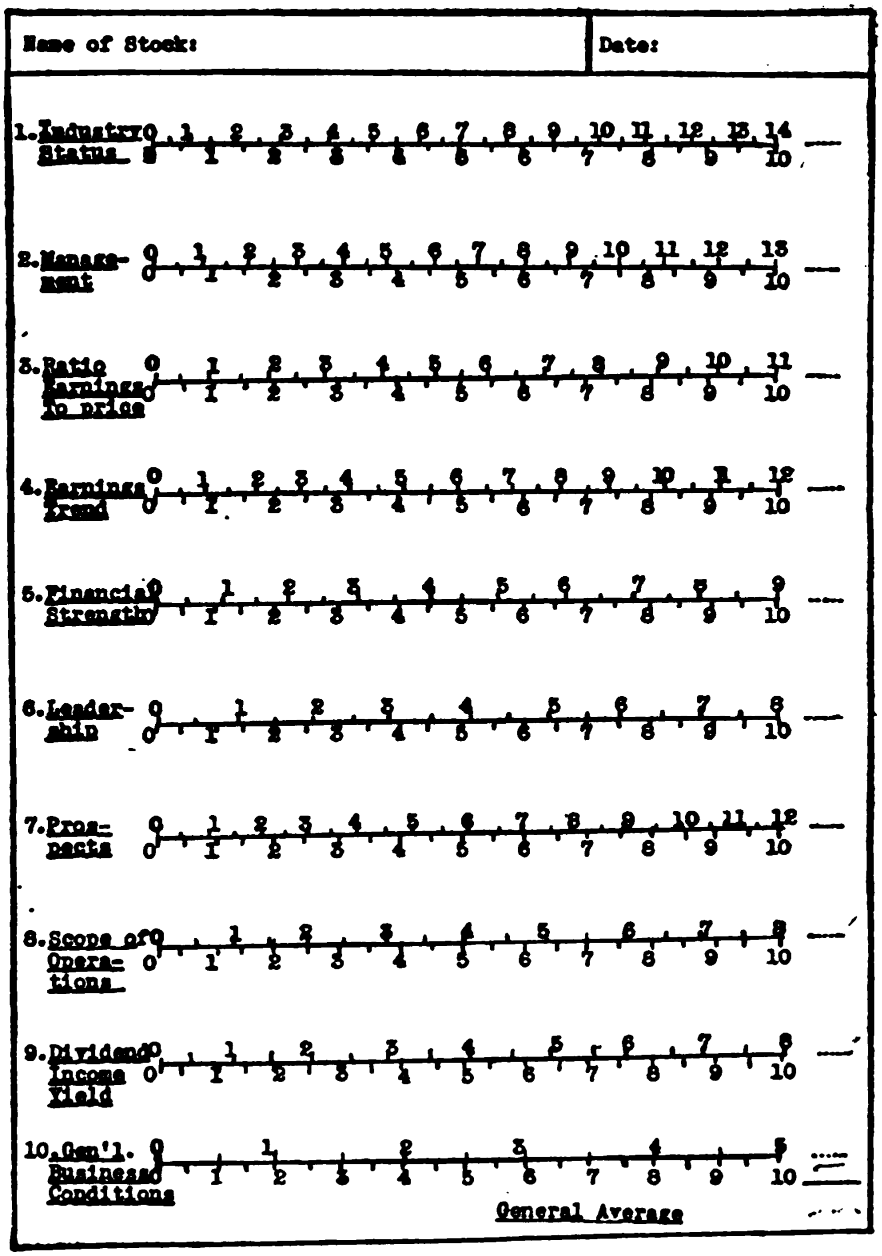
8. Scope of Operations—Diversity in manufacture or other operations has quite the same value in relation to hope of profits from a corporation, as has diversity in your "portfolio" of stocks that you own. In other words, a company whose scope of operations is on a broad scale, like that of the General Electric or General Motors or General Foods, making and selling many articles, is in the happy position of not having "all its eggs in one basket." It can make up in profits from one, its losses in another of its divisions of operation. Thus *scope of operation* is a factor in judging a stock. A company which makes but one article is in a much more precarious position. A company (like either of the big mail order companies) which has operated only one type of business, usually finds it necessary some time to make a major change to save itself when conditions alter the outlook. Rate companies on this point according to the diversity of their plan of operation. *International* operation should also count, for export sales are a stabilizer and have increasing possibilities.

9. Dividends—Income Yield—Buying of common stocks is usually for one or both the reasons of (1) yield (2) expectation of accrued value. Therefore yield is a factor, even when increase

in valuation is the main reason for buying. The average man's desire for income is making this an *increasing* factor. Figure out what yield a company's stock affords if any; using one of the statistical tables easily obtainable for ready calculation of annual rate of return or stocks at various prices and rates of dividend return. A stock which yields no dividend return should be rated at zero. A stock that yields 2% should be rated 2, and so on up to 10, the rate of return being the figure to mark it at. A stock that yields over 10% should be marked with a "plus" after it, so that it may be a marked stock, unusual and especially attractive; but of course the reason must be investigated, as it may be due to the fact that dividends are soon to be cut or stopped, or are not earned.

10. General Business Conditions—The simplest way to rate this factor is to take the general business index figure—selecting one from various ones published or provided in forecasting services—and use it as a guide. The New York *Times* Analyst's Index of Business Activity is one. There are others. The U. S. Department of Commerce Survey of Business covers *itemized* conditions indexes from different departments of business, but not a general index.

Most of these indexes take 100 as a normal or



"Measuring Stick" for Common Stocks; see text for explanation. Use blanks furnished in the rear of this book for actual marking. Extra blanks obtainable from publishers, 50c for 25.

basic figure, and then show the variations from 100 as the indicator. Take such a 100 or normal figure and let it represent 3 on the scale. If the indicator goes down 5 points to 90 mark your scale at the figure 2. If its goes up 5 points mark it at the figure 6, and if it goes up 10 points mark it 7, and so forth.

Final Calculation—After having rated all these factors, calculate the value of the marks, according to the figures on the top line, and then add the total. You can then compare different stocks under consideration, and say "this is an an 80% stock" and "this is a 60% stock." You have, then, as you should realize, achieved a notable thing in your work of judging stocks. You have used man's most marvelous tool, mathematical measurement, for values which are only too seldom measured. Imperfect your ratings are certain to be, of course, but they will not be nearly so imperfect as judgments made without such ratings.

Chapter XV

Some Examples of Successful Analysis in Selecting Stocks

BERNARD SHAW once said that there were only 50,000 people in the world who could think. Thought, he said, is not a natural function of the human mind!

It is perfectly true that great numbers of men and women hate all analysis. They resist the idea of using their brains. They persist in looking for easy rules o' thumb and for guides to follow, like sheep. Such people ought never to try to invest their own funds; they should in all cases let investment bankers decide on their investments. Independent thinking—without trusting too much to strong personal convictions, however,—is a real necessity in doing your own investing, and particularly in being an investor-speculator.

How does a competent analyst—an average man or woman—go about it? To many people the task seems too forbidding and difficult.

Let us give some instances. Let us assume first, that the average investor-speculator has for a period of time familiarized himself with the world of stocks. He has for months been reading the financial pages of good newspapers, and periodicals, and studied data provided by advisory services, and even read books on investing. If he is particularly alert he has made some "dummy transactions" for his own education—by which I mean that he has (purely in his mind) decided to buy, let us say, U. S. Steel common stock, and marked down in a memorandum book the record of that imaginary purchase. He has therefore secured the information he needs to apply the "measuring stick" mentioned in another chapter. Before "buying" he made the calculations called for, and found that U. S. Steel was rather attractive. So he made note of the price of Steel at the time of his decision, but passed on to other "dummy transactions," measuring other common stocks; but resolutely restraining himself from buying, and then later checking the record to see how good his judgment would have been had he *really* bought and sold according to his imaginary record.

Let us assume now that he has acquired understanding and has accumulated in his files a number of suggestions and recommendations for buying certain stocks. He has money ready to invest. He is ready for *action.*

He applies the "measuring stick" to those stocks which he has selected for analysis and finds that two of them, Union Pacific railway and the Standard Oil Company of New Jersey, rank at the top of the list in their calculated ratings. He then applies, one by one, the Twelve Test Principles which I list in this book, and finds that the purchase of these stocks will violate no one of these principles. The intrinsic values behind these properties are enormous; their strategic position sound, their financial backing solid and their record good; and they will help excellently to diversify his other holdings of shares. He has another railway stock, but it is an eastern railway, so he would be correctly spreading his risk geographically if he bought Union Pacific. He owns no oil stock at all. So far so good.

Now, however, he must do three very important and difficult things. First he must judge the general position of the railways and the general status of the oil industry. Second, he must judge whether the stocks are not already too high in value. Third he must determine whether

he is not buying at the top of a general stock boom period.

Taking railways first, he finds among other things that if he takes ten typical industrial stocks he finds that their ratio of earnings to price * is 18.4, whereas the ratio for the railways is only 13. This is fair evidence that railways, on the average, have not yet discounted the record earnings which it is evident (in November) will be shown for the year 1929. What is more, the typical railroad shows a yield of 1.02% more than the typical industrial stock.

This OK's the general position of the railways. How about the general status of oil? He has heard a good deal in recent years about the "over-production" of oil. He is appalled to find that in 1925 the stocks of crude and refined petroleum stood at 544 million barrels, but had reached 614 million barrels in 1928, or a 12% increase. Looks like over-production? But what about increased consumption, in our marvelous automobile era? Well, well! It works out that the increase of consumption is 24%, 1925-1928; twice as much as the increase in stocks of oil; so that actually the ratio of supply on

* A sample calculation: you multiply the number of shares outstanding, which is given in the manuals, by the price of the stock, and then divide the resulting figure by the total earnings of the last full year.

hand of oil to consumption is today only half what it was three years ago; a factor favorable to the oil industry. More than that, he reads of successful curtailing of production in California. Evidently production and consumption are now being brought closer together. There is also plenty of evidence also that costs have been widely cut, and that earnings for 1929 will be much larger (38 companies for one quarter of 1929 showing 27 millions in earnings, as against only 14 millions in 1928).

This OK's both the railroad and oil basic position of the industry. Second, what about the valuation of the stocks? Both the Union Pacific Railway and the Standard Oil of New Jersey are absolutely preeminent in their fields, their management is beyond reproach. Union Pacific, he finds, is selling less than 10 times the 1928 earnings from operations—as contrasted with the fact, above indicated, that this ratio for ten typical railways is 13. But not only is this very favorable, but Union Pacific earned $8 per share in addition, from its investments; it being virtually an investment trust because of its surplus holdings. Still more favorable, 1929 looks like a good increase; a total of $22 per share instead of 18. As for Standard Oil of New Jersey, its 1928 earnings were 4.43 per common share and

the 1929 probability is $5.75. The ratio of the stock price to earnings is only 12—contrasted with the record of ten typical industrial stocks above referred to, of 18.3. This, he decides is certainly excellent; but there is more. A stock dividend is rather well forecasted, as there is a 478 million dollar profit and loss surplus carried. Also, there are the most unusual chemical developments and research going on.

Very well; so far so good. Now what about the third consideration; that of whether this is not "the top of the market, and the wrong time to buy? At the time he is making this analysis (Nov. 15, 1929) there have been four or five terrible drops in the stock market. If there might be a question as to time to buy at some other period, there certainly is none now! It is actually panic time! It is a crucial time for an investor. The market is in a boiling, wavering position, and may still go lower. Here is where his cool independence comes in. He will act exactly contrary to the current "panic" feeling. He decides that it is far more important to base his judgment on intrinsic values than on market fluctuations; since fluctuations, up or down, do not really create or destroy inherent values. He sees nothing wrong with the basic prosperity of the country; nor do any of the other important

people whose views he has looked up. He decides that if there is any inflation left it is not in these stocks. He also ignores the low yield of dividends on this stock; he is emphasizing the point of view of speculative increase in value in this investment.

Here then may be observed a specific process of analysis based on facts. Notice that the long-time point of view, the investment idea, is foremost, in spite of the ignoring of the present income yield for future speculative considerations. Notice, too that there were to be found—in the middle of a supposedly inflated stock buying period—two common stocks of the highest grade which met every test of analysis as a real investor-speculator "bargain." It proves that neither rich men, nor investment trusts nor "the gambling public" have grabbed off all the "good things" still to be had—if the right analytical method is used to find them. It further shows that some of our greatest and most substantial corporations are most excellent, even neglected, investments, for the average man.

If we now examine some other instances, taking as a basis the very valuable experience brought out in *Barron's* contest, we will have further good schooling in sound investment-speculation. The prize-winner, Charles E. Brun-

dage went about his remarkably successful work very ably. He decided upon the 75% stock, 25% bond ratio (as advocated elsewhere in this book). This was to make a bulwark against unforeseen events.

Then Mr. Brundage chose common stocks in "sound and healthy industries and companies most strongly entrenched financially and strategically." He also decided to "buy into fields of business activity which are *growing up to* the country," such as the utility, electrical equipment, chemical and aluminum industries, and chain stores—instead of those growing *with* the country. This is a very penetrating and intelligent idea. He then decided to include some railroad stocks, because of the stable nature of the business. Another intelligent and clever idea was to buy low-yield stocks, on the basis that companies which retained a large part of their earnings were more competent to invest their funds than the average man; thus giving the average man's stock in such companies the character of an investment trust. Still another good thought was to invest some part of his money in "infant industries" with a future (rayon, aeroplane, radio). Of course by "infant," he did not mean entirely new-born industries in their disorganized period. The result was that

his prize-winning list, which made him an income of our $90,000 a year for two years, stood as follows.*

New York Central	Borden
Atchison	General Railway Signal
Atlantic Coast Line	Aluminum Co. of Am.
Missouri Pacific	S. S. Kresge
Electric Bond & Share	Westinghouse Air Brake
Southeastern Power & Lt.	F. G. Shattuck
United Gas Improvement	Du Pont
International Tel & Tel	Tubize Artificial Silk
General Electric	Curtiss Airplane
Union Carbide	Radio Corp. of Am.
Otis Elevator	Wright Aeronautical

The second prize-winner in this contest—whose stocks gave him a return of $123,547 in two years, bought common stocks with all but 5% of his $100,000, keeping this 5% in the savings bank. Thirty per cent of his common stocks were in public utilities.

The man who won third prize put 80% of his money in common stocks and 20% in long term bonds. His $100,000 went up in two years to $189,205. He spread his stocks over rails, industrials, utility, bank and insurance stocks. A "composite" of the 97 leading competitors in

* After a year he sold Kresge, Atlantic Coast Line, also some of the aeroplane stocks and bought Columbia Gas and Electric, Peoples Drug, Mathewson Alkali and Niles Bennett Pond.

this contest shows that the investment of $100,000 by these investor-speculators became $159,249 in two years. Very significant is the fact that the common stocks most often selected by these 97 contestants advanced 101% in the two years. What common stocks did these 97 men choose as most interesting? Here is the list—the work of many competent brains in agreement:

Rails
Atchison
N. Y. Central
Pennsylvania
Union Pacific
Industrials
U. S. Steel
General Electric
Union Carbide
Du Pont
Woolworth
American Tobacco "B"
United Fruit
Utilities
Standard Oil of N. J.
International Harvester
Am. Tel. & Tel.
Cons. Gas of N. Y.
Western Union
Banks
National City Bank
Chase Nat'l Bank

Of course the average man does not have $100,000 to invest. $10,000 is much more nearly "his size." However, he is not debarred from the same benefits as the wealthier investor because he can simply invest in fewer shares of the same companies, or plan in a period of two or three years to cover an entire list which he sets up as a goal.

Chapter XVI

Practical Suggestions for an Average Man's Data System

WHETHER or not anyone believes that the average man or woman should do exactly as some investment banker says, instead of making his own analyses, the fact of the matter is that *the average man or woman insists on it.* He or she distinctly wants to use his brains in the matter of investment, in most cases, particularly those who are business executives. They know business principles and they have no longer the notion of investments either as mysteries or throws of the dice as a matter of luck. They know it is a matter of business judgment, and since they have some of this quality they want to use it. They have not found, to be frank, that the investment banker has any monopoly on this quality. We are dealing in America

with an extremely self-reliant, independent type of character, and one with an inherent genius for business. Business risk does not scare this type of character. It is the natural atmosphere in which it moves and breathes.

For these reasons we have literally millions of people today—average people—who give some part of their time to the study of investments; which means in a large majority of cases, common stocks. At their home or in their offices they maintain some kind of files or data drawers, and aim in one systematic way or another to keep connected with sources of information and have on hand reference material.

I am therefore going to present here a quite simple plan, which any ordinary person can use, in selecting and handling the facts and data which can be of use in studying investments. To some who have spent much time and money on investment study this will seen too simple; but I insist that I want to be of most help to the average man or woman who is not very familiar with financial technique. Financial people are constantly making the error of assuming that they are talking to people who are technicians in finance—yet at the same time they are urging the public to consult financial

technicians. In other words, they rarely talk the language of the average man or woman, who frankly have no time or inclination for the technical lingo and detail of finance.

Let us assume the case of the average man; a business man or woman who either at home or at his office has common desk and vertical file facilities. Nowadays when a vertical steel filing cabinet can be bought for as little as ten or twenty-five dollars there is no excuse for anyone with money to invest to be without such common facilities, because they are essential to orderliness. This man or woman is desirous of using his brains on his investments.

Very well; the first concern he should have is to arrange for connecting with sources of information. This is the first point of failure for many people. They subscribe to one or another financial forecasting service, and are helpless under the resulting barrage of statistics in fine print which looks like a deadly dull and hopelessly involved mass of material. They attempt it bravely, and often develop a first-class inferiority complex as a result, deciding that they are just plain "dumbbells," and then they do what "dumbbells" usually do—follow the advice of the "tipsters" whose "tip sheets" are so simple and

so plain that a schoolboy could see and understand.

As a matter of fact, intelligent investment is not at all as difficult as all the forbidding mass of technical statistics would seem to indicate. One simply needs to know one's way about in the congested traffic!

What information should a man arrange to get regularly? I am going to make very specific recommendations, without being afraid to mention things by their names, even though they advertise somebody. I have in mind only the interests of the average man, and I won't stop to hem and haw trying to be too impartial by mentioning all services to be obtained. I will arbitrarily select what seems to me to be the most useful and practical and reasonable in price for the average man. In this way, I may be obliged to express personal preference, but I consider it more likely to be helpful than if I should confuse my reader by listing too much. I will list, however, a *secondary* group of material, for such people as can afford the time and money for a greater variety of material than I list in my primary grouping, which I consider quite sufficient for an average man. These are the various items I should recommend:

Reference Books (Primary List)

Moodys Manual of Industrials
New York World Almanac
Financial World Appraisal of Listed Stocks
Commerce Year Book, Department of Commerce, Washington

Reference Books (Secondary List)

"A Scientific Approach to Investment Management"—Rose
"Stock Movement and Speculation"—F. D. Bond
"Common Stocks as Long Term Investments"—E. L. Smith
Crowell's Dictionary of Business and Finance

Periodicals (Primary List)

Wall Street Journal, New York
Financial World, New York
Magazine of Wall Street, New York
Journal of Commerce, New York
Forbes Magazine, New York
Financial Section New York Evening *Post* (Saturdays)
Financial Section New York *American*
National City Bank, New York, economic bulletin

Periodicals (Secondary List)

Barron's Weekly
Commerce and Finance
Financial Chronicle
The Annalist, New York

Financial Forecast Services (Primary)

Survey of Current Business, Department of Commerce, Washington

United Business Service, Boston (because it is based on the united consensus of opinions of Harvard, Babson, Brookmore, Alexander Hamilton Institute and several others) and because it is simplified and moderate in price

Financial Forecast Services (Secondary)

Brookmore Economic Service, New York
Alexander Hamilton Institute, New York
Col. Leonard P. Ayres, Cleveland Trust Co., Cleveland, Ohio
Financial World Service, New York

The average man with the material indicated on the Primary list will have quite enough to keep him occupied with plenty of reliable material for thought. He should read it *promptly* and file it correctly, not hesitating to cut and tear the material and place it in its proper file space.

This filing plan I am now going to describe. He should buy 100 manilla file folders of the ordinary kind. Then using a heavy red pencil he should mark (printing the letters) the index spaces of these folders for the following simple headings:

A. *Immediate Buying Suggestions*

(in which to file notations of stocks which have been approved for buying)

B. *Hold for consideration*

(in which to file notations of stocks to investigate and judge)

C. *Tickler*

(in which he places matters marked to come up on specific dates. By keeping a calendar pad on his desk he will remind himself of the fact that there is something in the tickler file he should take out on this date)

D. *Receipts, Acknowledgements, Broker's Statements, etc.*

(a file for the records of transactions, etc.)

E. *Income Tax Data*

(data for use in compiling income tax returns)

F. *Opinions, Ideas and Forecasts and General Data*

(a file for such clippings, pieces from forecast reports, etc. which are deemed worthy of holding for another reading or reference)

G. *Data on Stocks Owned*

(a file for statements, reports and other data on the stocks already bought)

Letter File (with alphabetical index)

This equipment is extremely simple and efficient for the average man. But he must also go further. The above mentioned folders should be allowed to occupy one entire drawer of a vertical letter file.

Another drawer should be used for an altogether different file—a data file on specific in-

dustries, with a folder for each of the various industries or types of securities. A folder should be lettered for each of the following carefully systematized groupings of industrial concerns:

A 1—Agriculture
A 2—Apparel
A 3—Automobiles
A 4—Automobile Accessories
A 5—Automobile Tires
A 6—Aviation
B 1—Building Equipment
C 1—Chemical
C 2—Coal
C 3—Cosmetics
C 4—Copper and Brass
D 1—Drugs
E 1—Electrical Equipment
F 1—Fertilizer
F 2—Foods
H 1—Household Supplies
L 1—Lead and Zinc
L 2—Leather
M 1—Machinery
M 2—Meat and Packers
M 3—Mining and Smelting (not including copper)
M 4—Miscellaneous Manufacturing
M 5—Miscellaneous Services
O 1—Office and Business Equipment
O 2—Oil
P 1—Paper
R 1—Radio—Phonograph

R 2—Railway Equipment
R 3—Rayon
R 4—Retail—Chains
R 5—Retail—Mail Order
R 6—Retail—Dept. Stores
S 1—Shipping and Shipbuilding
S 2—Steel
S 3—Sugar
T 1—Textiles
T 2—Theaters, Movies, etc.
T 3—Tobacco
W 1—Woolens
X Y—Foreign

Then another division, in the same drawer, the *Public Utilities Division,* distinguished by the letters P U, as follows:

P U 1—Railways
P U 2—Electric-Gas-Water
P U 3—Telephone—Telegraph
P U 4—Traction-Bus-Motor Transport

Then another set of several folders, if desired, for Bonds, etc.:

BO 1—Industrials
BO 2—Railway
BO 3—Public Utilities
BO 3—Municipals
BOXY—Foreign

Here, for an expenditure of a few cents, is an equipment for quick and simple reference filing.

Into one of these classifications all the 1,200 stocks of the New York Stock Exchange and all others will fit, and the investor-speculator has the beginnings of his self-education and self-help in common stocks. He will be able to organize his own thinking so much better if he has organized the data which is the raw material of his thought.

Of course he should also keep the records of his transactions carefully. With this I am not so greatly concerned, as there are a number of well-designed accounting books for investment records. It is a question of how detailed he wishes to be in his records. Very obviously he should record, promptly, these items:

1. Price at which bought
2. Dividends earned
3. Price at which sold
4. Profit or loss.

The Great Practical Value of Charting:

Few average men are "figure-minded." Only accountants and those who work all the time with statistics are able to grasp quickly the important meanings, trends and relativities of a bunch of figures. The average man is repelled by them and he gets "figure-indigestion."

Yet figures, in regard to investments, are all-important. Particularly *trends*. Figures themselves do not show trends—they are merely lumps of facts, not arranged to show relationships. For this reason charts are very good indeed to use in studying stocks. They *picturize* the facts. This is why you see many charts used, even for financial men. These should be studied also by the average man.

But, in line with my idea for the average man of *self-analysis;* of making his own tests, I also advocate that the average man *make charts himself*. This is not in the least difficult. In the same time that it takes you to puzzle out the meanings of figures you can take a sheet of chart paper, of the handy kinds now easily available for just such purposes,* and with a common lead pencil chart the facts for yourself, and thus give them far more reality and clearness. A little attention to how to use the various types of charts will prepare you to make charts which should very clearly indicate which way you should decide. Such factors may easily be charted as:

1. The progress, up or down, of a company's earnings.

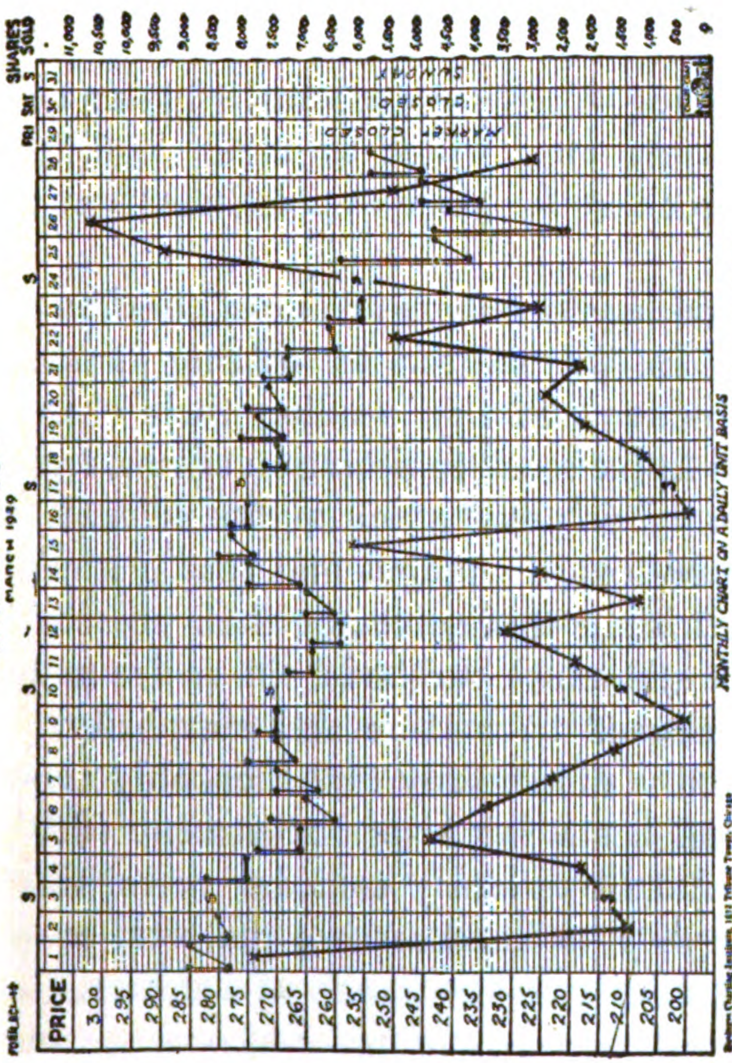
* The Business Charting Institute, Tribune Tower, Chicago, sells all kinds of "instant use" chart sheets at modest prices.

2. The course of the market price of a stock, over a month, a year, or a period of years.
3. The course of various ratios which may be figured concerning a company.
4. The growth of a company's earnings as contrasted with the growth of its volume, or the quotations of its stock.
5. The general growth of an industry in contrast with the earnings of a particular company in the industry.
6. The growth of a company's earnings in contrast with the general level of market prices or prosperity or commodity price indexes.

Etc., etc.

If you are keeping a certain stock under observation, chart the course of its market fluctuations (see chart of Wright Aero stock herewith as illustration). The tendency is shown to be downward); something which might not have been noticeable merely from the day-to-day fluctuations. Go back six months and study the action of a stock. If you are studying the general trend of the market, chart the leader or "pilot" stocks.

Prices of commodities—rubber, cotton, copper, etc.—have a very vital bearing on the earn-



Example of a chart form marked by an investor. This chart, blank copies obtainable from Business Charting Institute, Chicago, have two barometers, at left and at right.

ings of companies, and by charting these, too, you may be discovering a trend which will give you information of importance about stocks.

The Department of Commerce "Survey of Current Business," obtainable at only $1.50 a year, provides an amazing amount of basic data, index figures, etc., which is most significant material to chart for your own information and guidance.

Many average investors are most careless and neglectful in the matter of cutting coupons, cashing dividend checks, sending their changes of address to the stock registration offices, taking advantage of valuable stock rights offered, replying to notices of changes and readjustments, etc. By drilling themselves or their secretaries to observe systematic methods, the entire matter may be reduced to routine and simplicity. A person who is notoriously and incurably unsystematic and has a fair sized investment ($5,000 or over) should seriously consider permitting a trust company to handle these matters, or put his or her money in the hands of bankers.

Chapter XVII

Margin Speculation

FOR the average man margin trading in stocks is a snare and a delusion.

This is not a mere panic-time pronouncement, nor the fear-complex of an over-conservative man. It is not even a paternalistic worry about the welfare of the average man, remembering the losses of the panic. It is a cool, detached statement of principle, calculated on plain fact. Nor is it a hard-and-fast "doctrinaire" view or prejudice, as is demonstrated by the fact that I make provision for logical exceptions. A business man whose income is twice the sum of his normal living expenses, who buys on margin *occasionally,* (under circumstances explained here); or a long-experienced investor with ample reserves who operates within a carefully worked-

out policy of limitations—these are logical exceptions.

Margin trading, it should be said, is a perfectly legitimate operation. Used regularly by rich men and professional speculators it serves its useful purpose. But the average man, with a salary of from $3,500 to $10,000, or even $20,000, is not likely to be sufficiently advised and served, technically, to make margin trading a sound policy or advisable venture. It should be clearly understood that while margin trading *enlarges the opportunities for making profit, it also enlarges the chances of loss.* No trading is sound when the trader is not at all times prepared to meet the same degree of *loss* that he hopes for in *gain.* The small margin trader therefore is using an uneconomic degree of risk when you consider the proportion of his capital (cash and credit) which he employs in speculation.

Fundamentally, margin trading is a device for the technical purpose of speculation; not long-pull investment-speculation, but in-and-out trading. It is really a labor-saving device and convenience for those who are technicians in speculation; and also for those men of wealth, with extensive credit, who may logically assume large risks. For the *investor-speculator*—who is

an entirely different kind of an animal than the speculator, pure and simple—margin trading is not only *unnecessary to his operation,* but a temptation to wade out beyond his distinctly limited depth. There are those who glibly reply that the average man should have the same chance to use his credit as the rich man. *He has;* that is the trouble. Brokers are only too willing to invite in the "lambs"—and shear them. (Just now they are self-righteously hoping the public will stay away; but—wait!) No good business man would dream of accepting all the money that any bank is perfectly eager to loan him; he must at all times keep his credit position sound. Therefore no wise average man will regularly buy and sell stocks on margin, because it imperils his credit position too much. A sudden, vigorous "bear" swing may result in calls for margin which he cannot, or should not meet, and the result is disaster.

The average man who, on the other hand, buys in five and ten shares outright, and has the stock locked in his safety deposit vault, is independent of the devastating sudden drops in values (such as made a record for swift drops,—down 50%—in 1929). He may have a smaller line of securities, but he has safely tucked away the equity in the intrinsic values represented by the stocks;

something he does not have when he trades on margin. All this may be proved mathematically in a simple way. Take Mr. A. who has $3,000 a year surplus and decides to buy 100 shares of stocks on margin with $2,500 of it. He has only a $500 reserve fund, and when, in a serious drop such as has many times occurred, a margin call for an additional $1,000 comes and he is unable to meet it; he is "wiped out." He has not a solitary dollar or share of stock to show for his investment. Or he may salvage a small amount when "sold out." Contrast this with the position of the Mr. B., who instead of buying 100 shares on margin, bought 10 shares each of two or three stocks, with his $2,500. The showing is very different indeed. Let us say that one or more of these three stocks dropped just as far down as did the stocks Mr. A. purchased on margin. It is quite too bad, of course—*but Mr. B. still has the shares intact;* and as the intrinsic values they represent (if he was wise in his selection) are still there, he has only to lock up the stocks and go about his business. He will continue to draw the dividends paid on the stock, and some day no doubt they will perform as he expected them to, if he studied their future as intelligently as he should. Mr. A. laid himself open to sudden call for 150% of his surplus, when he had only

100%; whereas Mr. B. more scientifically laid himself open to only about 85% of his surplus.

The incurable gambling spirit prompts many people to reply "why not take a chance?" The answer is, no good engineer ever builds a bridge or a building on the chance that there will be no high wind-pressure which will go beyond the capacity of the structure. On the contrary, he calculates the *maximum* strain the building will have to meet, and then constructs it *with a margin of safety* to spare, beyond the highest known wind pressure for that climate.

The "wind-pressure" of the stock market can be calculated. Average drops in one day of as many as 25 or 35 points have been known, even in moderate price stocks; which means that some stocks have gone still further down. U. S. Steel broke from 261 to 150 in the panic and Am. Tel. & Tel. from 310 to 203. Breaks of 10 to 20 points may occur any time. Therefore an average man who carries a line of 5 or 10 stocks on margin, even only in ten share lots, has a liability of margin calls—not one, but *several*—of from $600 to $2,000; a sum which is usually beyond the range of an average man of about this buying capacity. Even the rich man must be a very seasoned, cautious man if he wishes to hold his commitments and liabilities within the strain

limits of safety. *It was, indeed, mostly the rich who in the recent panic lost appalling proportions of their surplus.* A market moving upward invariably tempts the average man, when he speculates, to take on more than he can carry. The average man is temperamentally inclined always to be a "bull"—which is only another way of saying that he forgets the storms that come suddenly over the market; forgets that values cannot stand this pushing upward process beyond a certain point, and that a reaction is then inevitable.

He forgets, too, that the average man rarely gets into the market early enough; *now,* for instance when there are real bargains. *Now* is precisely when he is refraining from buying, because of fright! Such is the state of the average man who cannot reason logically—as I am trying to do for him now.

One of the greatest rules which has ever been hatched out of Wall Street's chequered career is *have a fixed policy and stick to it.* This is precisely what I am advocating, (and of course I have behind me the opinion of most of the able men of finance, in their sincere advice to the average man). I advocate as *Fixed Policy Number One,* that the average man definitely consider himself to be an *investment-specula-*

tor, always remembering that the emphasis is on *investor,* not on speculator! Just as soon as the average man firmly fixes this in his mind—and the sooner the better—he will at once feel the mental benefits of this *clear fixing of policy.* His thinking will be more to the point. He will be able to reason his moves more accurately. He will be able to calculate his position and his actions with a surer *knowledge of the limits he must impose on himself;* and this is tremendously important. "Lambs" become lambs precisely because they roam blindly and follow any leader and any policy. Any "bell-wether" suits them as a leader; any friend's casual "tip," or any feeling of excitement or fear shapes their action. But not so the investor-speculator with a fixed policy. He knows where he is going, and he is seldom one of the sheep that are shorn. As Merryle Stanley Rukeyser puts it, "common stocks prove suitable media only for those with the resources and courage to withhold them from the marketplace in times of public hysteria." Exactly! And that rules out the average man trading on margin, for in time of hysteria his purchases are usually *forced* out of his hands; he hasn't the resources to hold on. It is estimated that in October 24th slump nearly half a million small traders were forced out. In later

slumps hundreds of thousands of others were also sold out. The millions of shares bought and sold on these black days represented *distress selling;* while most of the wiser *outright* buyers rode out the storm, and actually, the latter began to pick up the bargains with their reserves, *add to,* not subtract from, their holdings.

But just at this point is where we come upon the genuine justification of margin buying under special circumstances. The wise average man, the competent investor-speculator, has two great winning "techniques": (1) buying at any time carefully selected common stocks after detailed analysis, as explained in this book; and (2) *buying common stocks at undisputed "panic" periods.* This latter is the greater harvest time for the intelligent average man. The *unintelligent* average man at such a time is hysterically *selling* (or being forced to sell because his margins are exhausted), The wise investors and the rich men calmly watch while the hubbub is going on and pluck bargains "from the burning." The thinking average investment-speculator does the same. But to be *able* to do this he must have money or credit. If the "panic" or "big break" in the market is a genuine "bottom" (and usually, as in the October-November 1929 panic, there is not the slightest doubt about it) then it is entirely

sound to secure all possible credit to buy the stocks which have already been analyzed as sound investments, and which are now selling at bargain prices.

At such a time margin buying is justified by the average man; but only for the purchase of intrinsic values, not for market speculation alone; and only by those who have a secure income. A panic drags down stock valued conservatively as well as others, and this is the investor-speculator's opportunity to use his credit to buy common stocks of this kind in larger quantity that he has immediate capital to own outright. By buying judiciously on margin, with the credit he has established as an outright buyer, he can keep the bargain stocks on margin until he can afford to pay for them outright, or sell them. If he has more than ordinary capital or credit, he may even for the time being, in the middle of such a panic, let the speculator part of himself predominate; in other words buy stocks not for investment, but because they are temporarily "good buys," pulled below normal by the general drag downward. "Speculation" then becomes safe enough to have in it considerable investment element. Such stock he could plan to sell on a ten point rise, after selecting such as he wishes to keep.

This, however, is for the *experienced* and *well-advised* average man, and not for the *novice* in stock-buying. It takes market wisdom to be reasonably sure that the market is at or near its bottom. A panic often has a "double" or "triple" bottom; in fact it takes skill to catch the market at the right time in such a panicky period, and to pick judiciously for sheer speculation. Therefore the man who has a salary of less than $10,000 and a rather small capital should not indulge in margin trading even under these special circumstances. He should be content to buy a few well selected bargains outright as usual.

There is one other condition under which I should say that margin trading is permissible. It is when, as occurs occasionally, he finds some selected common stocks selling very far "out of line"; that is, stocks which through oversight or neglect have nowhere near achieved their rightful market price, and a careful check-up has indicated abundant reason why it should shortly be "discovered." In this class also fall stocks about which, through absolutely authentic, checked up sources, the fact is learned that a very good piece of news will shortly come out; greatly increased earnings, increase of dividend, merger on favorable terms, etc. This is usually, however, a kind

of news few average men are able to get before it has already been "discounted" by a rise in the stock; and tipsters are very fond of spreading such gossip. *Be very sure your news is new and authentic.* Genuine information is however sometimes received by average men situated favorably and logically for such news; and on such occasions margin buying for men whose general position is sound, is not bad judgment.

I do not know of any other good reason for margin trading by the average man; and even these ought to be subject to the most rigid tests and cynical inquiry.

Chapter XVIII

Buying Stocks On the Instalment Plan

BUYING "on time" is a method which is enormously prevalent in America. Its advocates have often claimed too much for it, and it still costs the consumer too much for the accommodation, in many fields. But in the purchase of securities it is as sound or sounder than in the purchase of any other goods. Stocks or bonds bought for investment are a constructive and productive purchase, and therefore fit very well the basic requirements for the time payment method.

In a year or two we are likely to enter an extension of instalment stock selling. This is evident, for instance, in the new plans maturing by the American Telephone and Telegraph Co. to sell stocks "on time." These plans are sig-

nificant, although the company has operated an instalment plan since 1922. Initial payments, which must accompany the application for shares under the plan, shall be not less than $50 per share, and subsequent monthly payments shall be $20 or any multiple thereof per share. Interest at the rate of 6 per cent is charged at the time of final payment, monthly instalment payments made on or before the fifth of any month being treated as paid on the first day of the month. At the time of final payment dividends to which the shares have been entitled will be credited to the account.

It will be noticed here that there has been eliminated from this plan the most objectionable feature of ordinary instalment buying—one which the simple-minded public has not always grasped—namely, the interest charge which as ordinarily calculated amounts virtually to 24% because of the usurious method of calculation. This new plan wisely protects the public from such usury, which, bluntly speaking is what it amounts to.

John J. Raskob, who had much to do with the development of instalment selling of automobiles on a wide scale when with the General Motors Corporation, was, before the panic, planning a huge enterprise to sell stocks to the aver-

age man and woman on instalments. He, too, has seen the fundamental injustice of having only the rich and well-to-do acquainted with the ways of making money by means of the growth in value of common stocks. Coming from an industry which has set the most brilliant example the world has ever seen of carrying what was once regarded as "a rich man's toy"—the automobile—down to the lower levels of income, it is very natural that Mr. Raskob should now think of carrying the benefits of shrewd investment down the same way, particularly to workmen. Mr. Raskob has now delayed this plan because of the panic, but this is unfortunate, since no time could be more advantageous. His plan was a form of investment trust, specializing on sound common stocks. He intended to make it possible for the factory mechanic with $200 saved up to buy $500 worth of the investment trust shares. The balance would be financed by a loan in a local bank, putting up the stock purchased as security, and paying off the purchase in instalments of $25 a month. This is virtually tapping the great reservoir of "consumer credit" about which we have heard much in recent years. Fundamentally it is entirely sound, if the lessons learned by investment trusts in the panic are used, and should particularly reach a class of

investor below the average—the worker who today is doing very little saving or investing. It is fitting that Raskob, who started in life as a $7.50 a week clerk and has now many millions—mostly invested in common stocks—should feel inclined to teach other workmen the technique of enriching themselves.

The purchase of investment trust shares on instalments had been forecast for some time, before the panic. Another project has been formed in the south, scaled down still further for the poorer folk. As little as *50 cents a month* will buy shares in this enterprise. This carries the benefits of the investment trust down about as far as it can go. Such projects, it is now clear, however, should be under regulation.

Of course the employes of large corporations—hundreds of thousands of them—have been buying their employing corporations' stocks on a time payment plan, on very liberal arrangements, as already described in this book. This has habituated them to the idea, and there seems no logical reason why they should not expand their purchases, for stocks are more desirable than some other forms of merchandise time payment buying. In fact there is abundant reason why employe stockholders should buy *other* stocks, since they are breaking one of the funda-

mental rules of investment by doing all or nearly all of their investing in one corporation, as many of them do. Some employers, such as the General Electric, recognize this need for diversifying employe stockholdings, and operate a form of employe investment trust, which counteracts the tendency to "put all their eggs in one basket."

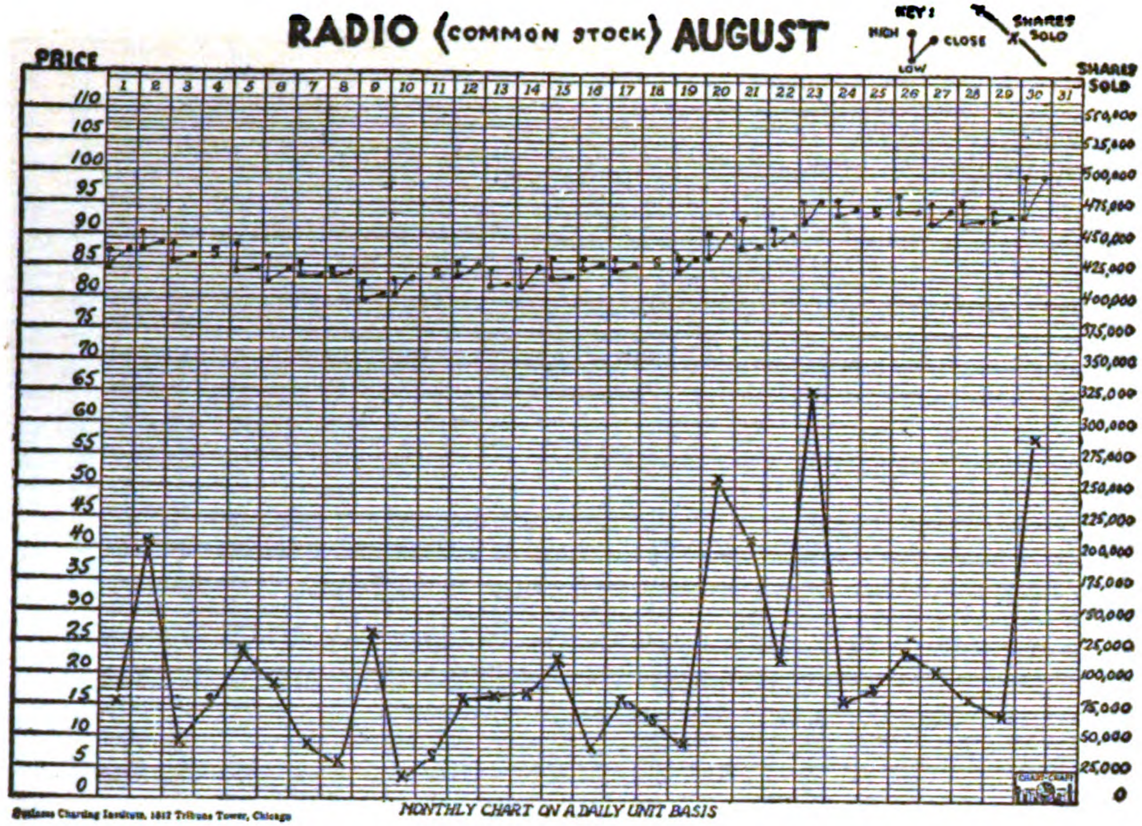
That remarkable man, A. P. Giannini, president of the huge Bank of Italy, whose advice hundreds of thousands of "average" people follow very faithfully, has gone on record as favoring instalment buying of stocks for the average man. Says he: "People who are dependent on a salary, and with a limited amount that can be set aside, after paying current expenses, will find no better plan of investment than the purchase of prime securities of well-managed businesses on an instalment basis. The investor is building his fortune out of earnings, rather than speculative or problematical profits."

The primary object of investment is to create an estate that will take care of the later years of life when the earning capacity of the individual is at low ebb. With a purpose of this sort, the small investor can hardly afford to take chances. There is too much at stake. The "average man" with money to invest should consider

carefully the soundness of the company and its future before risking his money, rather than risk his earnings on the possible "chance" that his investment might prove the right one.

A new principle has been introduced in Buffalo which achieves the effect which the instalment plan aims at, without the actual use of the instalment system. It is a "dollar share investment trust," whose stock is sold in units of one dollar each. Anybody can buy just one dollar's worth of this new investment trust, or up to $500 worth, on a weekly investment plan. There will be no deductions for management fees, and officers and directors receive no compensation. The entire dollar goes to buy securities. In this way the so-called "instalments" paid by those who buy, do not carry the burden of special "carrying charges" and there is no "repossession" difficulty or necessity to continue the payments. It is of course only another name for a savings bank, with the difference that the investment is not restricted to the securities savings banks are restricted to, nor is there the same legal supervision. This new plan is of course only as good as the ability and integrity of its founders and operators, but it is a very interesting development.

We are certain to see worked out on a wider



A chart marked by an investor for two factors, price and shares sold on the exchange day by day. Forms obtainable, Business Charting Institute, Chicago.

scale the sale of common stocks to the average man, for, I repeat, this is the era of the average investor, and investment methods must and will be adjusted to the situation of the average man.

Chapter XIX

Should Women Buy Common Stocks?

AS many as ten or fifteen years ago women began to rebel at the idea that they were weak things whose money must always be invested quite differently from the funds of men. They saw that men invariably bought bonds for them and almost never common stocks. Indeed, they very carefully bought for them only the most conservative and low-interest bonds. As almost every one now knows, a very high rate of safety can be obtained today by careful investment, at as high as 7% income return. Women were being given 4% to 5½% income at most; and in may cases no more than savings bank interest.

This excess of caution in women's investments is certainly to the credit of the advisers of

women, from one point of view, that of old-fashioned chivalry. But it has, frankly, overshot its mark. Not only was it quite too conservative even from the soundest investment point of view, but it was unfair to women. Nowadays women are not the swooning, weak and helpless things they used to be. Eleven million of them earn their own living, and, as I shall demonstrate in a moment, they are astoundingly wealthy. What is more, they are independent and unafraid, and despise the old cages and cautions which hobbled them. Their "weakness" was largely of man's imagination. They want to share with man the adventure of life. Even a common Mexican woman or Indian squaw goes to war with her man sitting atop a freight car. Modern women in the late war also demonstrated that they wanted to follow men into "danger."

There is no inherent reason why a very considerable number of women should not use precisely the same standards of conservatism as men; why she should not also be an investment-speculator. It is manifestly unfair that a woman should be ruled out of the fundamental benefits of growing in wealth with the country through ownership of common stocks. Women are now aware of this and are more and more seeing to it that they own common stocks. It comes as a

stunning surprise to learn that a majority of the common stockholders of many of our largest corporations are women!

But then it must be appreciated that 41% of the wealth of the country is in the hands of women. Women pay taxes on incomes totaling 3½ billions of dollars annually; and they are receiving 70% of the estates left by men and 64% of those left by women. They are the beneficiaries of 80% of the 100 billions of insurance in force today. These are gigantic figures. Men's paternal care of women in this wealthy country is certainly showering vast heaps of wealth into their hands, and I have no doubt that a very considerable part of the increased investment in common stocks and the decline of bond selling is due to the fact that women's funds are more and more being invested in common stocks.

It is a fact that over 50% of the stockholders of the American Tel. and Tel. Co., the Pennsylvania R. R. and the U. S. Steel Corporation are women. The same is true of the Westinghouse Air Brake Co. and the National Biscuit Co.

The wealth of women as revealed by income tax returns is equally startling. Taking all individual incomes over $100,000, women are actually in the lead—with 54% of the total! A

grand total of about 10 billions of taxable income is in the hands of women, according to latest estimates.

I submit, therefore, that it is proved women have the cash and the reserves necessary to invest their money on a *standard* basis instead of on a fenced-off nursery basis, as if they were children. The funds of a middle-aged salaried married man with a family dependent upon him are certainly to be treated no less carefully than the funds of a widow. It is true, of course, that a widow whose income from her funds constitutes her sole living is in a different position from a business man who is still earning a salary; but even when you consider the widow's special need, the old-time ideas of investment of her funds break down. She was being provided with too little income if her funds were small, and if her funds were large the excessive conservatism was without point, because there was no reason for excluding her from a certain degree of the speculative element. The widow may have children to send to college, and may actually be prevented from doing so by the excessive conservatism which keeps her from owning good common stocks.

Very excellent light is thrown on the newer and more sensible ideas of investment for a

woman by the contest held by ***Barron's Weekly*** in 1925 for the best investment for a widow. Over a thousand entries were made in this contest, and 14 were selected by the judges, who were very responsible bankers.

It is now possible, after four years have elapsed, to judge these investments by the passage of time, and see how these 14 theoretical widows would have fared. It is rather a startling and revealing disclosure; fully demonstrating what I have just said, that women should, like men, profit from the long-time ownership of common stocks.

One hundred thousand dollars were supposed to be invested for a widow by the contestants. The investments selected by two of the prize winners *doubled* their value in four years; thus providing the widow with $25,000 a year income in new value, not including the income received as dividends, which amounted to about $5,000 a year in 1925, and ended up at about $9,000 a year. True, the panic-time low prices cut the accrued valuation to a 50% rise instead of a 100% rise, but who would tremble at this? The stocks will rise again. The investment was of course mainly in common stocks. The skill with which these were selected is of course responsible for the result. But it is important to note that

all of the 14 prize-winners made a creditable showing when their investment selections were put to the proof of four years of time, (up to panic-time). The *lowest* market appreciation in this period (on common stock investments) was about $17,000. The contestant who specified all preferred stocks showed an appreciation of $8,885. One of the contestants specified *all bonds,* and his list showed only $145 market appreciation up to the panic, which, even on bonds, wiped out *all* of this gain. The *income* on this bond list was $4,860 at the start, and of course the same at the finish; *but not the principal.* Could anything be more convincing as to the injustice done women whose funds are diverted entirely into bonds? (Unless of course her total funds are less than $10,000 in which case no one disputes that they had better be in "gilt edge" bonds, or preferred stocks.) The widow whose $100,000 were invested in bonds in 1925 *does not even have her original capital intact* (calculating at panic time prices); and that of course is the most serious thing that can happen to a fund. All the theoretical widows owning more than 25% of common stocks, even at panic prices, still have their capital intact, and have an income of about $7,500. The superior *safety* of well selected common stocks, as contrasted with

bonds, is here demonstrated; yet "safety" has been attributed only to bonds in past years.

As *Barron's* remarks, the selection of bonds for widows was based on the erroneous assumption that the purchasing power of a fixed income and the general standards of living would not change during the widow's life. This is the fallacy against which I am arguing; the injustice to women against which I protest. A compromise on preferred stocks is at least some steps forward, and no woman, even if her funds are $10,000 or less, should be without some of these, in order to lift up her income percentage. Seven per cent on good preferred stocks is today almost as safe a selection as ever bonds were, for we are now realizing that bonds have some risks, too.

Quite obviously, however, women are somewhat less competent to use their own judgment in investment than men. Very few women should attempt to make their own investment analyses. It is not unfair to say that they have not the same coolness of judgment, as a rule, as men. They should seek the advice of the progressive but well-recommended, investment banker. He will undoubtedly concede the point that, if she is still a salaried earner or fairly well-to-do, her percentage of common stocks should be higher.

Just how high, it might reasonably be asked? I shall venture a personal opinion, as follows:

1. For a woman employed at a fair income, with funds not larger than $5,000, the proportion of well selected common stock should be 10%. The proportion of preferred stock should be 25%.

2. For the woman *unemployed,* dependent on investment income, with funds not larger than $5,000, the proportion of common stock should be *zero.* The proportion of *preferred* stock should be 25%.

3. For the woman, employed at a fair income, or with other property yielding income, with funds of $5,000 to $10,000, the proportion of common stock should be 25%, and the proportion of preferred stock also 25%.

4. For the woman unemployed, dependent on investment income, with funds of $5,000 to $10,000, the proportion of common stock should be 20%, and the proportion of preferred stock 30%.

5. For any woman with funds of $10,000 to $25,000 the proportion of common stock should be 30% and preferred stocks 40%.

6. For any woman with funds over $25,000 the proportion of common stock should be 50%, and the proportion of preferred stocks 30%; or

possibly 75% common stocks, conservatively selected.

7. For any woman with funds over $100,000 the proportion of common stocks may approach 90% if the selection is very well balanced and conservatively made.

I realize that investment trusts (very carefully selected ones) have changed somewhat the outlook for women's investments. They have made it entirely possible and safe for a woman even in Class 1 as listed above to invest 25% of her $5,000 in funds in investment trusts owning largely common stocks. This increases the "hazard," but if the investment trust selected is a particularly solid and well-backed one, and not one of the newer and less solid institutions, there is no real danger. Indeed, it is particularly sound advice to a woman to invest a considerable proportion of her funds in a fixed investment trust (not a trading or holding corporation); particularly in some of those which diversify their holdings among common and preferred stocks and also bonds. In this way, through the list of stocks owned by investment trusts, a woman may have an equity in a much larger percentage of common stocks than she would if she bought them individually.

We must accept the fact that women are

more robust today and more on a par with men. Women are, indeed, not waiting for us to accept the fact; they are simply going ahead in their own right and scorning, often, some of the safe counsel of men which they should heed. During the October-November 1929 upset a woman operating from one of the brokerage-by-radio offices on board a transatlantic steamship, lost $180,000 by her reckless margin speculation. This seems too bad; but there were of course many men who lost even more. If women wish to make the same profits as men from their investment-speculation, they will have to be willing also to face the same losses and hard blows. She must be self-reliant, prudent and analyze her steps if she does not wish to be kept in the investment nursery. For years it has been said that women are bad investment losers and have often made scenes when they lost heavily. Brokerage houses at one time would have nothing to do with women's accounts. Today, some brokers have set up special offices for women. It is a fact that many thousands of women were stock speculators during 1929. It is to be hoped that they too will learn, as the average man is learning, that his real role is that of investment-speculator—with the emphasis on investor.

Chapter XX

What and Why Is An Investment Trust?

ENGLAND has had investment trusts for sixty years, and there have been some in America for 35 years, but in the last several years they have leapt forward by great strides. Over two billion dollars of investors money was turned over to them in 1928, and they now have about 3½ billion dollars in their care. They are now, after the panic, somewhat in eclipse, and I do not believe they will ever again become widely popular.

An investment trust in theory is an organized way of investing on a large scale in diversified or varied securities, giving the average investors the advantages of the expert aid of trained investment managers, and part ownership in many stocks through the simple device of a corporation

share. This share represents genuine ownership of a variety of stocks and other securities, constantly watched over, analyzed and changed (except in the case of fixed share-trusts). An investment trust is thus virtually a pool of money (some critics insist that it is a "blind pool") owned by many people, and invested as one fund by investment experts; or perhaps more accurately still, it might be called a stock-buying syndicate. Instead of managing separately a thousand small amounts placed in their hands for investment, the managers of investment trusts make up large blocks or "units" of money, which are invested as though they were the funds of a rich man who hired expert help to invest these funds properly. The only difference is that the ownership is in small pieces, open to any one, instead of one big ownership.

There are five different kinds of investment trust shares obtainable: (1) those called "general management" trusts, free to invest in securities in all fields at any time, (2) those which specialize on certain fields or kinds of securities, (3) those which operate on a fixed or limited management, (tied down to specifically named shares), (4) those which are holding and financial companies, and (5) investment trust bonds. The first type is the most popular, but not necessarily

the best. The fixed share kind has the merit of being strictly confined to shares in certain companies, which the investor himself may then follow and study, to check up his investment. He may also "trade in" his own shares, if he owns any, in the corporations whose stock this type of investment trust "fixes" upon. Thus if you own some Texas Corporation stock, you can trade in each share for a 650/715th share in the stock of the Blue Ridge Corporation which is based on ownership of shares in 21 well-known corporations.

The average man or woman finds the exact details of an investment trust plan difficult to comprehend. Let us take a random specific example, the "Leaders of Industry" a "fixed" common stock investment trust. Each participating trust share, represents one one-thousandth participating, non-voting ownership in 73 shares of common stocks deposited with a trust and savings bank. These common stocks consisted of 12 shares in five railways, 12 shares in six public utilities, 12 shares in four Standard Oil Companies, and 37 shares in 18 industrial companies. The stock in this trust is all common stock, and is sold in denominations of 5 to 100 shares. in all these companies. Thus one certificate, purchasable at one sum, may be bought representing

an investment in 33 separate companies; one piece of paper and one worry for the average man instead of 33 worries—and of course his risk scattered just as the old saying warns "don't carry your eggs all in one basket." The investment trust investor thus has his eggs in 33 baskets. The dividends and stock purchase rights coming from 33 companies are collected by the trustee and twice a year distributed pro-rata among the shareholders. The dividends are free from the Federal income tax. The shares in the investment trust can readily be sold at any time, but after 15 years the trust will be dissolved. Holders of 1,000 shares or multiples of 1,000 may at any time surrender their shares and receive instead the underlying shares. The total expense of administration is ⅜ of 1% annually.

The best opinion today favors a combination of the best features of the "management" trust (which can buy or sell the securities on the list as they like) and the fixed share trust. One is too flexible, and the other too inflexible. The method is to have a fixed "reserve list," as well as a fixed regular list. This opinion is mine also, and I recommend the selection of investment trusts of this type; fixed on specific investments, but with reasonable provisos for selling and substituting.

The investment trusts were very hard hit by the panic. Most of them lost from 30 to 60% of their funds in the crash, and a few of them were wiped out. They face a long period of painful recuperation, and consolidation on a wide scale is certainly forecast. Their prestige is to a large degree broken, although it should be said that they weathered the panic better than the average individual margin speculator. However, this is no feather in the cap of the investment trust; *it is a feather in the cap of the buy-outright plan.* I would go so far as to say that any individual who had followed faithfully the principles laid down in this book in the investment of his own funds, with a good investment banker to check up his decisions, if he was a novice, would have had as good or better a record in the panic than most investment trusts.

I advocate most carefully selected investment trust securities for women with small funds and those who do not particularly care to work out their own common stock investments. But they should buy into *new units* or blocks of shares, bought by investment trusts after the panic at bargain prices. I am not enthusiastic about investment trusts for the average man. A number have been promotions; others are merely adjuncts to banks and have been hastily organized,

and are not of sufficient size to provide an economical expense ratio, and in consequence have not provided the care in selection and management required. They have depended heavily on "turnover" profits instead of current income, and now in a depression period they must revise themselves. Before the panic 85 investment trusts had returned 11% to investors and had in addition 14% undivided profits; a brilliant showing—but it was a "sunshine" showing, and it is a different story in a "rainy season."

The truth is that the investment trust has been much over-exploited; a common trait of the American people. They constituted one more "bonanza" type of security, like railway, automobile, radio, aeroplane, etc. and in the same manner overdone. Like all bonanza fields, they now need a long period of readjustment before they can be regarded as on a stable, sound basis. Meantime, the average man can do better without their help.

There is another slant in this investment trust subject which should also be of interest to the average man or woman. Certain of the large corporations of the country *are in reality "investment trusts,"* because of the large amounts of surplus which they have, and because of the fact that this surplus is invested expertly in a wide

variety of good stocks—including large blocks of common stocks. Buy a share of their common stock, and you have actually purchased a share of investment trust stock, since such a common stock share is necessarily entitled to a share in any profits which they make from their investments. In many ways such an investment is really superior to investment trust shares, because there is a double strength to them—the earnings from their regular business and earnings from their invested surpluses. If their earnings *from operations* are pinched and fade away, then they can draw on their earnings from their investments to pay their dividends. This is actually what some corporations do; there are a number of instances of large corporations which made more money from their surplus investments than from running their business! In fact, the corporation tax statistics uncover the surprising truth that 27% of the income of American corporations comes from other sources than from sales of their goods!

Such corporations as U. S. Steel Corporation, Allied Chemical & Dye Co. and some others, can be regarded, to all intents and purposes by the average investor *as investment trusts,* better than most of the investment trusts specializing as such.

It is a very good bit of advice to buy some of the stock of these companies.

Trust companies and other banks are awakening now—since the success of the investment trusts—to the logical position a bank is in to render investment trust service to the public. The Irving Trust Co. of New York, for instance, has organized the Irving Investors Management Co., after making a survey to determine how it should broaden its service. By this new method anyone—an individual or a corporation—may create separate "trusts" and place them in the care of this new service. The usual methods of an investment trust are then used, two general investment "pools" or funds being operated; one for income and one for accumulation.

As a matter of fact the average man or woman investor-speculator *can operate a little investment trust of his own,* using his own capital and applying the diversification principle with intelligence and care. Everything that an investment trust does, the intelligent investor-speculator can do. He can even have high class advice, for there is no lack today of high grade advice available for the average man, if he searches for it.

The man or woman who has the right qualities of judgment, experience, intelligence, and the will and the time to use them and analyze his

every step, can undoubtedly make an excellent showing over a long period of time, so that his funds will represent what is to all intents and purposes a miniature investment trust. The smallest investor speculator can apply this principle, since there are some very low-price common stocks on the market which have merit, and which if very cautiously and carefully selected would constitute a small diversified investment trust group for as little as $30 per group of three shares, one each in three separate stock exchange common shares. Ten shares each of the common stocks of three such companies would come to only $300, and 100 shares each to only $3,000. Of course low price common stocks should be scrutinized with very special care.

Chapter XXI

Tabloid Analysis of Common Stock Outlook

(By Specific Industries)

IT has long been known by shrewd investment experts that the most effective possible way to pick good investment-speculations was first to pick *the line of industry* which was in a healthy and growing condition, and *then* to pick the strongest stocks in that industry. This is not the manner in which many people go about it. They hear something about a particular company and study the facts about a particular company. But the truth may be that while this particular company is fairly prosperous, *the general trend in the industry is downward,* and this will sooner or later affect the particular stock.

In this chapter I propose to take the industries which are classified in Chapter XVI and provide a brief long-time view of their status and pros-

pects, and at the same time for quick reference, *rate* them, with one, two or three stars, or one, two or three X's according to a scale of values based on these future prospects. The background for this data is the extensive industry research work which my research organization has been doing for years. We have individual research reports of 100 to 200 typewritten pages on each of over 500 lines of trade and industry; many of these having been the basis of consolidations or analyses by bankers and banking houses who have engaged us. This extensive research work is, we are convinced, the most complete of its kind in existence. Each analysis here given is brief and simple, but exceedingly well backed with merchandising judgment of the future sales prospects of these lines.

I feel therefore that I am sharing with the reader of this book a great and rare stock of industrial data, even though I can provide but selected bits of significant fact and judgment. The future of an industry depends, basically, upon intra-industry competition; that is, the effect of the competition of another industry which may be displacing or undermining it. Thus the growth of commercial laundries, for instance, is naturally somewhat at the expense

of electric washing machines; the growth of brick is at the expense of concrete or lumber or steel; rayon is at the expense of silk or cotton. But these factors must be weighed very carefully to avoid error and theorizing, and so must many other factors which are marketing factors. The future of an industry rests very heavily on its marketing outlook. This is precisely the sales and marketing outlook upon which I have specialized.*

I mention this to indicate that the tabloid statements here are not the mere usual financial and statistical summaries so often seen, from familiar standardized sources. They are on a broader base of information, and from the point of view of the industry's sales future. The classification key is also given for convenience in conforming with the system outlined in Chapter XVI. Naturally it should be remembered that time changes everything. This data is compiled in December 1929, but it is written from the point of view of a year to five years ahead, so far as it is humanly possible to forecast. However, since December 1929 is admittedly the very beginning of a new level and period, after the

* As is illustrated by my books "Modern Salesmanagement," "Selling By Telephone," "Modern Salesmanship," "Masters of Advertising Copy," etc.

stock-market crash, the forecast should have a maximum period of validity for the future.

Let me briefly explain the rating marks:

* means first class, bright future prospects; the topnotch of desirability for investment.

** means good prospects, but with some contrary factors which limit the possibilities.

*** means rather indifferent prospects, with very spotty conditions; some companies in the field with fair prospects, but an outlook calling for much caution and "choosiness."

X means an industry that is in a slightly declining or poor condition, but still not entirely bad, and with some companies worthy of study.

XX means an industry which is marking time or declining slightly and is already rather flat, or in a state almost forbidding investment, but which may "come back" at any time.

XXX means an industry which is very definitely in the doldrums with few bright spots, and which should absolutely be avoided.

We will now begin the tabloid forecasts, industry by industry:

A1—Agriculture X

The farmer and the industries dependent on the farmer trade are not in an optimistic position.

The returns from 1929 crop sales will be somewhat lower than in 1928, and the level of farm prices shows no increase. Farm equipment industries are getting heavy foreign orders which help greatly. In general the status will be approximately equal to 1928, with some likelihood of lowering. Two or three year outlook *good,* because of promise of Federal Farm Board action for betterment, and outlook for effective cooperative national marketing, such as dairy, interests are now at work on, among others.

*A2—Apparel****

The feminine side of this field is facing a style uncertainty with fair chances of winning through to larger volume because of the gains of longer skirts and general style accompaniments of radical change. It is not yet absolutely settled whether women will accept the long skirts, for street or office wear, but they will for evening wear. Apparel industries showed a 32.6% decline in the third quarter of 1929. The industry as a whole is of course one of rapid changes and considerable uncertainty, but also large gross profits in some favored lines and specialties. Stock market losses have slightly lowered clothes purchase volume.

*A3—Automobiles***

The 1929 production total of approximately 5½ million cars is a record breaker, due to Ford production, but it is not at all likely that even a 5 million rate will be maintained for 1930. The Ford price cut puts pressure on the industry, and is likely again to press hard upon the smaller companies. The Ford and General Motors have huge foreign manufacturing programs; the Opel works in Germany, (controlled by General Motors) now produces 50,000 cars a year, and within 5 years will produce 200,000 a year. Because of Ford's mounting volume, the General Motors and many others did not have as good a year in 1929 as in 1928. The pressure of competition is now ominous in the automobile industry and 1930 is not likely to be very remarkable; about 4,500,000 cars. The three or five year outlook is good for a few companies, but not for all.

With Ford again a vigorous competitor, using his old method of lowering price, the average price of cars must necessarily sag lower, which seriously affects also the used car market. Competition in multiple cylinder models is also pinching producers and their profits. Eight, twelve, and even sixteen-cylinder cars fitted against declining average price levels, together

with a style conscious market dominated by women, makes a hard combination, which only the strongest companies can face. Meantime, a slight depression adds to the narrowed outlook.

*A4—Auto Accessories and Equipment****

Following to a large degree the fortunes of the automobile industry, this field has, however, serious problems of its own. There is now definitely a reduced market for replacements, because cars are made better in the first place and because roads are far better and the wear-and-tear smaller, in the second place. For example, ten years ago the average number of spark plugs bought per car was about four. Today it is only *one*. More or less similar conditions prevail throughout the equipment field. At one time, also, many accessories were bought by car owners, especially Ford Model T owners. Today all cars, including Fords, come with far more original equipment of accessories. The outlook for this industry is not particularly promising, despite the fact that 1929 showed a 39% increase over 1928.

*A5—Automobile Tires****

For the same reasons as outlined in automobile accessories, the tire field has experienced a narrowing effect. Better roads and also higher

quality and new-type tires have reduced the number of tires bought per 1,000 miles of use. Although this is partly compensated for by the doubling of the average number of miles a car is driven annually (6,500 miles at present), still there is a net deficit. Competition is intense and the outlook is for still greater concentration of original equipment orders and thus profit narrowing.

Stocks of tires are increasing, and production therefore falling off. The two year outlook is uncertain, although tire shipments will increase some; from 78,500,000 in 1929 to probably 84,000,000 in 1931. Manufacturing capacity has, however, been increased by 7½ million tires, exclusive of foreign plants; and the U. S. Rubber Co. is now in large volume output.

*A6—Aviation***

Bonanza psychology had hit the aviation field and deflated it even before the stock break. The production of 38 millions in the first six months of 1929 was a disappointment. The deflation has sent the high pressure aviation stock salesmen looking for other fields. However, even if only 5,000 instead of the expected 12,000 aeroplanes were built in 1929, the industry is working toward higher levels, which speculators

had too eagerly anticipated. However, there are 10,000 licensed pilots now, as compared with 2,700 in 1928. The conservative outlook is for about a 20 to 30% increase in 1930. Four major groups offer the best hopes in this field, and although they are sound companies there is still much mere speculation in their prospects. It is not yet thoroughly proven that aviation will have a really huge development in the U. S., although it is certain of considerable development. The five year outlook is good, but not an El Dorado; about 25% growth annually.

*B1—Building Equipment****

There has been a definite recession in this field, except in a few spots. Heavy construction increased 17%. The nine-months record in all cities throughout the country for all types of building was 13.2% below 1928, although New York City showed a 6.3% gain. Hoover activities point now to heavy construction boom, good for two years. Steel construction is showing a more optimistic trend, the volume being close to four million tons, a record. Rapid obsolescence of buildings in expensive sections of cities is the cause, and this must continue. The stock panic has released plenty of "mortgage money," lack of which was one cause of building recession.

Building material prices are favorable for building, and there is reason to believe that a new building impetus will start. Retail stocks are low. The two year outlook is much better, and the five year outlook very good. The two billion utilities program also gives impetus to construction activity, as well the public works program.

*C1—Chemical**

This industry is making very rapid strides forward due to immense expenditures in research and the working out of new types of goods, or the cheapening of production. The 1929 showing over 1928 was 52%. Since the war America has come into a great chemical era, seizing leadership from Germany. Prospects for five years are very bright, profits very excellent, and growth in sales at the rate of 20% to 50% per year for many companies. Many factors are contributing to the strong position of this industry which is one of the most promising in America. The companies making basic or heavy chemicals, however, are not sharing the swift pace of the rest of the industry.

*C2—Coal***

This field has two very distinct branches—anthracite and bituminous. Anthracite has taken

a severe lesson and decline, but is now reorganized along modern lines, and has a very excellent outlook; driving for 50 million tons instead of merely trying to hold on to its 30 million ton level. It is introducing modern machinery, concentrating its breakers, reducing its mines and striving to please the public and meet oil burner competition by boosting automatic stokers. Its five year outlook is particularly good, owing to new water power and other big "white coal" projects. The bituminous situation, on the other hand should be rated at XX; it is cursed with too many mines and too many miners. Only a few companies are prosperous. Consumption of bituminous is increasing, however. The 1929 showing over 1928 is 30 to 36% gain.

C3—Cosmetics XX

This field has made enormous headway in recent years; a per capita (per woman over 15) of $52 per year; but it has an enormous mass of small producers, as well as foreign competitors, and is cursed with consequent price cutting. It is a difficult and uncertain field, but one in which certain selected companies have been making very good profit. It is an industry of quick drops in volume (as for instance a 29% drop in the 1920 depression). A degree of recession is inevitable

following the stock panic. It is a field calling for the most careful scrutiny. Fashion and the fickleness of women affect it, also other dangers.

*C4—Copper and Brass****

Copper has been hurt by general conditions limiting the earnings for the weaker companies. Dividends for the strong companies are not endangered. The tremendous railway electrification programs and the very healthy state of the electrical equipment industry point to a solid basis for the coppers, despite the automobile recession. Copper stocks have been pushed exceptionally low in price until they offer heavy yields. Machinery is tending upward, so that this also helps the general two year outlook, which is good; with a revival of building activity within the year as an additional likelihood. Copper production has been declining and is down 25% below 1928. Copper prices seem now successfully stabilized. Two year outlook fair.

*D1—Drugs***

In this group come the makers of home remedies and toilet preparations which are not cosmetics. This field is one of trade-marked specialties and a very profitable one for well established brands, though a very treacherous one for new brands, of which there are vast

numbers. Consolidation has been the order of the day in this field, and this has developed several very strong companies, some of which are strategically allied with big chain distributors. Advertising is a very vital essential in this field of high sales cost but very high gross profit. Selected firms in this field have attractive possibilities. There is a per-family consumption today of $17 for patent medicines and compounds. The average family expenditure in city drug stores per family is $64 per year. The field is growing and the two year outlook good.

*E1—Electrical Equipment**

This is another "top notch" field with a brilliant outlook. All types of electrical equipment are prospering because of the general modernization program going on everywhere, in homes and factories, and in the widespread new operations in railway electrification and long distance power transmission, particularly smaller distributing lines. We are in an era of transfer from steam to electric power; and in the home and on the farm from hand to electric power. 67% of American homes are wired, and average current consumption climbs at the rate of 5 to 10% per year. A million new homes a year are wired. By increasing sales, rates and prices are being

reduced, which still further stimulates sales. Electric appliances are making rapid progress, and the new freezing processes are calling for electrically refrigerated freight cars, delivery trucks and retail stores. The industry is certain to expand on a still larger scale. The five year outlook is most excellent. The General Electric and Westinghouse each scored about 30% increase in sales in the first half of 1929 compared with 1928.

*F1—Fertilizer***

This industry naturally turns upon the agricultural field, described elsewhere, which is now trending slowly upward.

*F2—Foods**

Ever since the war foods have moved upward to new levels and remarkable developments are still to come. The industry is advancing with great strides, not only technically in new processes, but in strengthening by mergers and in closer and more effective relations with the consumer and distributors. The distance between manufacturer and consumer is being shortened, modernization of both production and selling method is going on apace, and broader policies are being adopted. This applies not only to food companies as a whole, but also to the great

meat packers, now desiring to enter chain store selling. Huge "circular" or distribution types of mergers have been made in recent years. The canners of food are lifting up their standards and increasing per capita consumption of canned foods. More and more foods are being sold in packages. More will as the new freezing and packaging processes get under way. Giant mergers like General Foods, Standard Brands, Bordens, National Dairy Products and the new Hershey-Colgate-Palm-olive-Kraft-Phenix consolidation are certain to transform the food field still more. It has a brilliant future, but these large mergers are so new that a critical eye should be kept upon them for a few years, as they are still frankly experimental, but with excellent assurance of success.

The American consumer spends 41 cents of his retail dollar on food, and the American workman's wife sets a generous table. The food industry's five year outlook is remarkable. The 1929 gain over 1928 was about 18%.

*H1—Household Supplies***

The American home has already undergone several revolutions and is now in process of half a dozen more. The advent of the bathroom was an innovation, then the first furniture revolution

came, displacing old horse-hair sofas, etc.; and then came a suburban home and apartment standard, followed by an electric era of vacuum cleaners, washing machines, etc. Now furniture is having another revolution, (with many mergers now appearing); also furnishings and carpets and rugs, and the whole range of equipment. Improvements and new price levels—the application of the Ford principle—have greatly widened the field. Mergers of the type successful in the food field—as for instance the Simmons Co.—have put new life and vigor into furniture. Artistic furniture *of metal* is now coming into vogue—and the sleepy old carpet and rug manufacturers have now begun to sell direct to retailers and bestir themselves. The appliance companies have long been alert, and successful although house-to-house selling has been giving way to the resale plan of selling. Radiator and plumbing supplies are in an excellent condition, and the largest companies should show unusual profits in next year or two.

Every year 1,250,000 couples marry and start homes, and every ten years 25,000,000 new homes are begun, displacing the old;—virtually changing the country's style in homes every two decades, for every bride has her own decided ideas of how her home must look. The break between

old and new generation is particularly strong at present. A complete re-styling job is demanded. The manufacturers have, as a matter of fact, been slow to appreciate the consumer's desires, or else they might be profiting more from it. As it is, only a selected few are really prosperous; the demand for alertness and style having caught the field napping, except the electrical appliance field. The five year outlook is splendid, but only for the strong, alert firms. The 1929 gain over 1928 was about 14%.

L1—Lead and Zinc X

This field is somewhat narrowed by low prices, trending still lower, and to some extent with overproduction. The large companies are, however, in fair condition. The declining price movement in lead is as severe as any in its history. Surplus stocks of zinc ore and slab zinc are very high all over the world, and prices falling.

L2—Leather X

Leather consumption is now exceeding production, thus easing a long period of dullness in this field. The production is at a high level, hide supplies are low, and supply stocks held by shoe manufacturers are 15% below 1928. Prices are

steady and the industry is in a generally sound condition and hopeful. But there is no indication of unusual prosperity or developments, and the industry is not very attractive to investors.

*M1—Machinery***

The Government is now busy researching obsolesence of factory equipment; admitted to be at least 45% obsolete. Machinery manufacturers have been working to capacity in 1929, although orders have slumped from their 1929 highest peak since 1919. Industrial machinery has been changed with such rapidity that there has been created what is called "technological unemployment," but as Ford says labor may be shifted, but it is usually to a better job.

The rapid pace of industry and the widespread acceptance of the "scrapping" theory, makes for a very good outlook for all types of machinery, even agricultural machinery. The export outlook is also exceptionally good. There is a definite movement on to speed up obsolescence of machinery. The re-consolidation and modernization of factories marged also improves the outlook, which is excellent for the two to five year period. The 1929 gain over 1928 was remarkable —about 45%.

*M2—Meat and Packers***

If the packers get their desired "consent decree" modification from the government, as they probably will, enabling them to open chain stores, there is no question but that a new era will arrive for them, as it has to the mail order field. They are already preparing for a revolution; cutting the meats into the form the consumers want it, freezing it in the new "birdseye" manner, and packing it. The waste usually sold for 1½ cents a pound by the local butcher, will be worth 9 cents at the packing house. The best cuts will be sorted out and sold to the best advantage in the best neighborhoods, and vice versa, instead of the present inefficient method. If the packers own their own retail stores they will revolutionize the meat business. In any event, the new frozen, packaged meats will be sold very widely at drug, grocery and delicatessen stores, instead of only meat shops. Possibly the declining per capita consumption of meat will thus be raised.

The packers have not had brilliant success with all their by-product efforts, notably soaps, etc. They will doubtless now do a brilliant concentrated job of meat selling, make more profit and serve the public better. The two to five year outlook is splendid.

*M3—Mining and Smelting***

This mining field (not including copper) is in a fair condition. Smelting, however, is in excellent condition, running at near capacity. American Smelting earned almost $10 a share in 1929, and has undistributed earnings. Mexican disorders have now ceased, which has helped. The two year outlook is very good. The 1929 gain over 1928 was about 30%.

*O1—Office and Business Equipment**

There is no doubt but that about 60% of office equipment today is obsolete. The change over from wood to steel has not yet been made anything like complete; nor has the mechanizing of accounting—despite the splendid value and service offered in both these fields. The fruits of the various consolidations completed in the last five years are now ripening, and all of these large companies could pay more dividends, and are prosperous. Foreign sales are particularly good. 1929 showed about 30% increase over 1928.

*O2—Oil**

Vigorous efforts to hold down the production of oil are being made, and there is clear evidence that it is succeeding in key localities, notably California. A total reduction of 60% is accom-

plished. Meanwhile, the rate of consumption has also climbed. The production at refineries of gasoline for 1929 was 17% higher than in 1928, and consumption was 14% higher. The oil situation has one bugaboo—overproduction, with consequent price reduction, which is now temporarily averted. New research developments and chemical possibilities—particularly those of Standard of New Jersey—indicate an excellent five year outlook for the strong companies. Oil burning is on the increase in many fields—ships, domestic heating, railways, aeroplane, and even factories. The automobile outlook is quiet, but average miles traveled per car annually is increasing fast (now 6,500).

P1—Paper X

The newsprint position is now better, and some of the "high-finance" promotion methods dropped. The industry is in no particularly promising condition however. The earnings of one large company is below dividend requirements. The 1929 showing was 20% below 1928. There is a struggle on to raise prices, likely to add 20 millions to income.

*R1—Radio and Phonographs****

There are now about 10 million homes out of a total of 28 million which have radio sets. Sales

in 1929 were just under four million sets. The industry is just emerging from the bonanza stage to a sound state, with a few very large companies in a fairly stable position. But it is still rather treacherous, the "obsolescence" rate being very high and sudden, and the price cutting and the "dumping" of overproduction stocks serious menaces. The stock market break brought on very lively dumping and price reduction because of heavy overproduction. There are still too many manufacturers; consolidations are in order as a weeding out process. The patent situation is rather obscure and complications unending. Meanwhile the perfection of television impends, and the broadcasting situation is not wholly satisfactory. The outlook is difficult to foresee, and the two year view is vague and uncertain. The phonograph industry is now bound up largely with the radio industry, and the same words apply.

*R2—Railway Equipment**

Big things in railway equipment are brewing. Huge jobs of electrification are about to start. After a period of several years of narrow buying, railways are now about to buy on a large scale. The General Railway Signal orders doubled in 1929. Greater cash income by rail-

roads has meant orders for equipment. A significant opinion now prevails among railway men that whether or not worn out, old equipment should be scrapped. Very rapid progress has been made in designing new equipment; while automatic train-stopping devices, automatic stokers, roller bearings for passenger cars, etc., have won their places. Steel cars, it is decided by the American Railway Association, must displace all wooden ones within a few years. Freight car and locomotive orders for 1929 were double that of 1928.

The immediate outlook for 1930 is narrower, but the two year outlook is splendid. The 1929 gain over 1928 was about 20%.

*R3—Rayon**

This is one of the few "bonanza" industries existing in America today, and it has stabilized itself more quickly than others because of the large capital necessary to produce it, and the settled character of the product and the market. From 39 million pounds in 1923 it rose to 137 million in 1929. About 25% of production is used by cotton goods manufacturers and 15% by the silk goods industry. Rayon is intimately co-related throughout the world, in very large, substantial companies. In 1913 we produced

only 5% of world production, but we now produce one-third. The five year outlook is very good.

*R4—Retail (chains)***

The retail distribution field is beset with basic difficulties, but has been making brilliant efforts to master them. The chain store has now about reached the peak of its unit development, apparently. Though numbers of stores are increased, profits per unit store decline. This foretells a slowing up in acquiring new stores, and concentration on policies that will raise profits. The A. & P. policy of selling more standard brands appears to be winning over the opposite Kroger policy of featuring private brands. Ninety per cent of chain difficulties are with its personnel of store managers. Affiliations with manufacturing groups are now beginning in some fields.

The chain store is now definitely out of the bonanza class, and spectacular profits need not be expected. Its profits may even lend to narrow, but it has brilliant executives and there will be continued progress by the ablest chains, also many consolidations. Sales for 1929 are about 25% ahead of 1928, but of course this is in large part due to addition of new stores. General re-

tail earnings for 1929 were about 10% above 1928.

*R5—Retail—(Mail Order)**

Already the large mail order house has spectacularly succeeded in transforming itself in part from mail order to chain store. It has not yet however demonstrated that its new growth is firm and free from the blights which have come upon other chains, such as too much chain competition, too narrow profits, too high cost of operation and store management and personnel unequal to their tasks. Volume has risen, as in the case of other chains, because of multiplication of stores, but it remains to be seen whether the unit stores profits will continue satisfactory. Both large companies show 1929 gains of 50 to 75 millions in sales over 1928. The chances are that for a period of years the results will be good, as the mail order chains are entering the small town field, as yet not over-exploited by chains; the same domain in which the Penney stores made their record showing over all other chains. The two year outlook is very good; the five year outlook a little more doubtful.

*R7—Retail (Department Stores)****

Some of the shrewdest merchandising brains in the world are concentrated in the department

store field, which some years ago arrived at its peak of growth, just as the chain store seems now to be arriving. Its cost of doing business has steadily risen, and also its competition from specialty stores, small shops and chain stores. It has in the last several years applied the merger policy to bring about a new era for itself; also group buying, but with no really demonstrated success. Profits have narrowed meanwhile for department stores doing a business of less than a million dollars. The specialty stores seem to be slightly better off. The outlook is only fair, except for selected stores.

*S1—Shipping and Shipbuilding***

A new era is on for this field. Considerable gains are being made; the third quarter of 1929 showed a 97% gain over 1928. European passenger traffic is very heavy; new ships are being built for service on all traffic lines, and shipbuilding is good with selected companies. There are likely to be rate wars however. The huge new plans for inland waterways is a sample of the five year outlook, which is fair. Tremendous new ship building orders are about to get into action. Ten ships a year at a cost of five millions each.

*S2—Steel**

Decline in automobile orders for steel and some price weakness account for a moderate recession which is not very important. Steel, during most of 1929, ran 17% ahead of 1928. Railroad buying is very good, and more orders for freight cars than any year since 1924. Steel construction is 16% ahead. The 1929 steel total is record-breaking, and while there will be some uncertainty and declines, both in volume and in prices, in 1930 there is no doubt that steel will continue its advance in due time. Steel is the material of the age. The two or three largest companies are in a better position than the so-called "independent" companies who are usually operating at 10 to 15% below the operating percentage of capacity at which the big companies operate. It is likely that steel construction tonnage in particular will continue to rise because of new applications, and increase in heavy construction. Railway requirements will also be large for several years, and also that of machinery. Steel's two year outlook is very good. The 1929 gain over 1928 was amazing—about 80%. Steel gains 10% per year.

*S3—Sugar***

Price in the sugar field has trended downward, but authoritative forecast is for an upward turn. The tariff appears likely to be of some benefit to the beet sugars. Meanwhile the candy slump is mending, and 1929 shows about 8% increase in candy consumption. The sugar consumption in America inevitably tends upward. World production is lower, which is a brake on price demoralization. The sugars are therefore in a fair position for the year's outlook. The two year point of view is not exactly certain.

T1—Textiles XX

Few industries have been as flat as the textile field, or remained flat for so long. The truth is that the industry was not keeping up with the business pace and was burdened with a very dangerous and cumbersome traditional and personal method of management and distribution. It has also undergone serious decentralization from New England, but the new concentration in the south has struck labor difficulties, inevitably pointing to higher labor costs. Silk is in a fair condition, and is not seriously endangered by rayon. Cotton is at the bottom, with an uncertain outlook.

*T2—Theaters, Movies, etc.***

Consolidation goes on rapidly in this field, particularly in the movie field, which is a great deal better managed than the regular theatrical field. The new Paramount-Warner consolidation is particularly advantageous, with 1,400 theaters controlled. The "talkies" are taking well all over the world, and while the expense has been huge, it has already been justified. Warner's earnings increased phenomenally in 1929 and the new combination will have a 30 million earning power. The regular theater is having a much less profitable time, and the talkies have also hurt the vaudeville circuits. Only the movies have a splendid two year outlook. The 1929 gain over 1928 was remarkable—about 60%.

*T3—Tobacco**

The making of records in cigarette sales has gone on without cessation in 1929, and the industry is in first class shape, especially now that prices have been advanced and the price cutting done with. Cigarette consumption rose from 72 billion in 1924 to 100 billion in 1928, and the 1929 consumption is about 115 billion. But cigar production is also gaining, 3.6% over 1928, due to low-price cigar development. There is

of course much competitive uncertainty in this field, but it is prosperous despite it.

The increasing use of cigarettes by women is a powerful factor and the pushing of this trade has been very adroitly done. The two year outlook is very favorable. The 1929 gain over 1928 was about 13%.

W1—Woolens X

The long doldrums show some signs of ending as the consumption for 1929 is an increase over 1928. The large companies have announced price cuts, on a basis of increasing volume, and this is certain to mean difficulties for the smaller companies, although the larger companies are in none too secure a position. The new style changes will be of some value, and as they seem fairly permanent, the two year outlook for the larger companies may be regarded as improving.

*XY—Foreign***

The selected foreign companies whose securities are sold here have a very fair outlook, as Europe is gathering new economic strength month by month. Some of the foreign issues have particularly good prospects. The foreign cartels are learning how to apply modern methods, and a modernization program is sweeping Europe and elsewhere. England is alone

lagging, although some of her issues are in excellent condition. The political situation is clearing up, and in the five year outlook is some promise of an "economic union" in Europe with real hope of greater profit and rise in the general purchasing power of Europe, which will be a favorable development for America, and even, by indirection, improve our South American trade.

*PU1—Railways***

There is no question but that the railways have very excellent prospects. Their typical yield was 1.02% larger than the typical industrial in the middle of the boom period, and it sold at only 13 times average 1928 earnings as compared with 18.4 for typical industrials. There is also $250,000,000 of undistributed earnings. Record earnings for 1929 are reported. The railways are entering a period of greater efficiency and greater profit. Net operating income is considerably higher, and total car loadings have passed the best previous record. Gross revenues are also about 5% ahead of the previous peak year; and 1929 gain over 1928 was 30%. The 1930 outlook is not roseate, but the two year outlook is excellent, particularly for some of the railways in favorable positions, which are even now able

to increase dividends. Five year outlook is only fair.

*PU2—Electric Gas-Water**

The electric companies have been making splendid records and have pushed up by 5 or 8% the average consumption of electricity among the 18 or 19 million families whose homes are wired. Production of electric power has increased since 1923 at an average rate of 11.6% per year. For 1930 it may not be more than 7 or 8% however. The gas companies have in recent years become very active and have 17 million customers, and increased consumption of gas 100% in ten years, customers increasing 50% and revenue increasing 70%. Natural gas is making big gains. Gas may expect a steady gain of about 10% per year.

All electric, gas and water companies have been showing increases almost every month. There have been wide developments in consolidation and re-grouping, and the top peak of the stock boom was in the public utilities, which have been somewhat over-expanded and over-capitalized. There is now therefore a certain reaction and conservatism called for in regard to them. The two year outlook is very good; five year outlook remarkable.

*PU3—Telephone-Telegraph**

The Bell system is in splendid condition, and use in the Bell system, and 4½ million more in independent systems which are now rapidly being consolidated. The Am. Tel. & Tel. has very valuable interests in subsidiary companies such as the Western Electric Co. which wires theaters for the talkies and is doing a boom business. The Am. Tel. & Tel. Co. plans to spend 2½ billions by 1935, particularly for long distance service, which is increasing. Total revenue has been increasing 10½ % per year.

PU4—Traction-Bus-Motor Transport X

The street car field has been very much harassed for some years now, but has been showing some gains from operating economies. It is not a field which invites investment (with a few exceptions) while the motor transport field is going through an era of promotion and boom and is equally doubtful. Motor coach operations of electric railways are booming. Hundreds of millions of dollars worth of subway equipment are also being ordered by New York and Chicago. The 1929 gain over 1928 was about 6 or 7%.

Chapter XXII

Common Stocks That Seem to be Bargains for "Long-Pull"

IT is always a difficult thing to make out a list of stocks that are "bargains," but service to the average man, the aim of this book, calls particularly for such a list, because shrewdest buyers of stocks have always *bought at panic-time prices* and at almost *no other time*. There is no more authenticated piece of advice than this. Naturally, the investor-speculator, whose first principle is buying to hold for a long time, would find the ideal time to buy during the period when prices were at the lowest over a period of years. For this reason in 1930 good stocks will be cheaper than they will be again for three to five years.

The list of stocks printed herewith is no "snap-it-up-today" and "take-your-profit-tomorrow" list. It is a list of common stocks which is ideal

for the investor-speculator who wants his funds to "grow with the country." They are given here not as "tips," but as splendid selected starting points for investigation and comparison. They represent what might almost be termed a general consensus of opinion of bargains at the after-panic price levels. Even after they are bid up beyond the prices ruling in December 1929, when this is written, they will still be "bargains," for they are *fundamentally* bargains, not superficially. Many were regarded as "bargains" by responsible advisors at prices even above the high prices of 1929. Use this list to which to apply your own measures and judgment.

General Selective List

Here is a list of what undoubtedly are *the best common stocks on the New York Stock Exchange.* It is an inclusive list, but eliminating carefully all the "dead" and mediocre ones. Every stock having any real possibilities for the long pull of the next two years or more is named here. *These stocks will remain good purchases, I am certain, during all of 1930.*

I show the approximate panic-time low prices, for use in comparison with prices current at the time the reader uses this list. These stocks are good purchases, of course, at figures consider-

ably above these panic prices—at which naturally, they were rare bargains. I show also the dividend yields. At the right, is a double star (**) which indicates *special* selectiveness and attractiveness, for one reason or another. A star (*) at the dividend figure indicates that in addition to the regular cash dividend there are extras or stock disbursements.

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
Adams Express	20¾	—
Air Reduction	78	3.00*
Alliance Realty	85	2.50*
**Allied Chemical	198	6.00
Allis-Chalmers	35½	2.00
**Am. Bank Note	75	2.00
Am. Brake Shoe	41	2.40
**Am. Can	86	3.00*
Am. Chicle	27	2.00
Am. Express	205	6.00
Am. Home Products	40⅛	3.60
Am. International	30⅞	2.00*
**Am. Mchy. & Foundry	145	4.00
Am. Power & Light	65	1.00*
Am. Radiator	29½	1.50
Am. Rolling Mill	64	2.00*
Am. Safety Razor	45	4.00*
**Am. Smelting	62⅞	4.00*
**Am. Snuff	38½	3.00
Am. Steel Foundries	40	3.00

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
**Am. Tel. & Tel.	203	9.00
Am. Tobacco	170¼	8.00
**Am. Tobacco B	172½	8.00
Am. Type Founders	115	8.00
Am. Water Works	51¾	1.00*
Anaconda Copper	70½	7.00
Atlantic Refining	36	1.25*
**Atlas Powder	97	6.00
Beechnut Packing	45	3.00
**Best & Co.	26	2.00
Bethlehem Steel	79¼	6.00
Bohn Aluminum	37	3.50*
**Bon Ami	71	5.00*
Borden Co.	56	3.00
Borg Warner	27¾	4.00
Brooklyn Union Gas	99	5.00
Bullard Machinery	25	2.00*
Burroughs Adding Mach.	38⅛	1.80*
**By-Products Coke	23	1.00
Calumet & Arizona	74	10.00
**Calumet & Hecla	27½	4.00
Canada Dry	50¾	5.00
**Case Threshing	130	6.00
Cerro de Pasco	52¼	6.00
**Chicago Pneumatic Tool	21⅞	—
Chile Copper	55	5.00*
**Coco Cola	101	4.00
**Columbia Gas & Elec.	52	2.00
**Columbian Carbon	105	4.50*

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
**Commercial Credit	20	2.00
**Commercial Investment Trust	29	—
Commercial Solvent	22	—
Commonwealth Power	107¼	4.00
Conde Nast	35	2.00
**Congress Cigar	47	7.00
Consolidated Gas	80⅛	4.00
Continental Can	40½	2.50
Continental Insurance	46⅛	2.00
Corn Products	70	3.50*
Cruscible Steel	76	5.00
Curtis Publishing	100	7.50*
**Cutler Hammer	58	3.50
**Detroit Edison	151	8.00
Diamond Match	118	8.00
Dominion Stores	12	1.20
**Drug Inc.	70	4.00
**Du Pont	80	4.00
**Eastman Kodak	150	5.75*
Electric Power	3⅛	1.00
Electric Stor. Battery	55	5.00
Equitable Bldg.	31¼	2.50
Federal Light & Trac.	90	6.00
Federal Water	28	2.40
Fidelity Phoenix	47½	2.00
First National Stores	48	2.50
Foster Wheeler	33	1.00
General Am. Tank	75	4.00*
General Cigar	42	4.00

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
**General Electric	168⅛	4.00
General Foods	35	3.00
General Gas & Elec. A	58¾	1.50*
General Gas & Elec. B	111½	8.00
General Mills	50	3.50*
General Motors	33½	3.00
General Public Service	20	—
**General Refractories	50	4.50*
Gillette Safety Razor	80	5.00*
Glidden Varnish	26	2.00*
Gold Dust	31½	2.50
**Granby Copper	48	8.00
Grand Stores	39	1.00*
Grant Stores	44	1.00
Hawaiian Pineapple	60	2.50*
**Helme Snuff	84	5.00
Hercules Powder	25	1.80
Household Products	40	4.00
Howe Sound	35	4.50*
**Ingersoll Rand	120	5.00*
Inland Steel	75	3.50
**International Business Machines	109	5.00
International Cement	50	4.00
**International Harvester	65	2.50
International Hydro Elec.	23	2.00*
International Nickle	25	1.00
International Printing Ink	42	2.50
International Shoe	54	2.50
**International Silver	95	6.00

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
International Tel. & Tel.	53	2.00
Interstate Dept. Store	25⅛	2.00
Intertype Corp.	17½	1.25*
**Jewel Tea	39	3.00
**Johns-Manville	90	3.00
Julius Kayser	30	4.00
**Kennicut Copper	49⅜	5.00
Kraft Phoenix Cheese	27	1.50
**Kresge	28	1.60
Kress Chain Stores	56	1.00
Kroger Grocery	38¼	1.00
**Lambert Drug	80⅛	8.00
Lehigh Cement	100	7.00
Lehn & Fink	28	3.00
Liggett & Myers	80½	4.00
**Liggett & Myers B	125	7.00
Loew's Theater	32	3.00
Loose Wiles	39⅛	2.60
Louisville Gas	28	1.75
Ludlum Steel	22	2.00
**Macy	110	3.00*
**Magma Copper	35	5.00
Mathieson Alkali	29	2.00
McCall Publishing	70	4.00
**McCrory	90	2.00
McCrory B	80	2.00
Melville Shoe	30	1.40
Miami Copper	20	4.00
Montgomery Ward	49¼	3.00

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
Motor Products	36	5.00*
**Myers & Bro.	30	2.00
National Bellas-Hess	10	1.00*
National Biscuit	140	6.25*
Nat. Cash Register (cum. A.)	59	3.00
National Dairy Products	36	2.00*
National Lead	129¼	5.00
National Power & Light	23	1.00
**National Supply	99	7.00
**National Surety	80	5.00
**National Tea	31⅛	2.00
**Nevada Cons. Copper	23¼	3.00
North American Co.	66½	10% stock
Oppenheim Collins	50	5.00
**Otis Elevator	195	6.00
Outlet Dry Goods	55	4.00
**Pacific Gas & Electric	42	2.00
Pacific Lighting	58⅛	3.00
Pacific Tel. & Tel.	131	7.00
Packard Motor	13	.30
**Paramount Famous	35	3.00
Peoples Gas	208	8.00
Phelps Dodge	31	3.00
Pillsbury Flour	30	2.50*
Poor B	20	2.00
**Prairie Pipe Line	45	3.50*
**Proctor & Gamble	43⅛	2.00
Public Service N. J.	54	2.60
Purity Bakeries	55	5.00

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
Railway Express	24	2.00
Reynolds Tobacco	70	2.40
Reynolds Tobacco B	50	2.40
**Ritter Dental	43	2.50
**Rossia Insurance	28	2.20
Safeway Stores	92⅛	3.00
St. Joseph Lead	38½	2.00
Sears Roebuck	80	2.50*
Shattuck (Schrafft's)	25⅛	1.00
Shell Union Oil	19	1.40
Southern California Edison	45⅛	2.00
Spalding Company	30	2.00
**Sparks, Withington	13⅛	1.00
Standard Gas & Electric	73½	3.50
Standard Oil of Calif.	51½	2.50*
**Standard Oil of N. J.	48	1.25*
Standard Oil of N. Y.	31¾	1.60
Sun Oil	57	1.00*
**Telautograph	15⅛	1.05*
**Texas Corporation	50	3.00
**Texas Gulf Sulphur	42½	4.00
Tidewater Oil	14	.80
Timken Bearing	58½	3.00
Timken Detroit Axle	11½	.65*
**Truscon Steel	33	1.20
Twin City Transit	28	4.00
Underwood Elliot	82	4.00
Union Carbide	59½	2.50
Union Oil of Calif.	42⅛	2.00*

Stock:	Approximate Panic Price:	Approximate Panic Price Yield (Dollars)
**Union Tank Car	121⅞	5.00
United Gas Improvement	22	1.00
U. S. Industrial Alcohol	95	6.00
U. S. Realty	50½	5.00
U. S. Steel	150	8.00*
Universal Leaf	25⅛	3.00
**Utilities Power & Light	24⅛	2.00*
Vanadium Steel	37½	3.00
**Vick Chemical	33	2.50
**Warren Bros. Paving	105	4.00
Western Union	155	8.00
Westinghouse Air Brake	36½	2.00
**Westinghouse Electric	100	4.00
White Rock Water	27⅞	3.00
**Woolworth	52¼	2.40
**Wright Aeroplane	30	2.00
Wrigley Gum	65	4.00

Special Selections, from an Income Yield Point of View

More attention is now being paid by the average investor-speculator to *income* yield, as a result of the deflation of hopes of accrued valuation. This is a natural reaction, although too much emphasis on this point is quite as short-sighted as the opposite.

Here is presented two lists of stocks, all rep-

resenting substantial companies, particularly the first list, and yielding fair to unusual dividends at the November 1929 prices. But these stocks will continue to offer good yields even when they rise in price, as they likely will, slowly, during 1930.

Stock	November Price	Div. rate in $	Approx. yield Per cent
Republic Iron & Steel	76¾	4	5.2
U. S. Steel	164¼	8	4.8
Bethlehem Steel	86⅜	6	6.9
Crucible Steel	78⅞	5	6.3
Am. Smelt & Refining	73⅞	4	5.4
Anaconda Copper	83⅜	7	8.3
Calumet & Arizona	88	10	11.3
Kennecott Copper	64½	5	7.7
Am. Tobacco	189¾	10	5.2
Columbian Carbon	139	5	3.6
Inter Business Mach.	129⅞	5	3.8
Inter. Cement	50	4	8
Inter. Salt	63	6	9.5
Endicott Johnson	53	5	9.4
Corn Products	86½	4	4.6
Stand. Oil of N. J.	60¾	2	3.2
Texas Corp.	53⅞	3	5.5
Nash Motors	50½	6	11.8
Mack Trucks	71	6	8.4
Gen. Motors	41¼	3.60	8.7
Chrysler	32	3	9.3
Marmon	24	4	16.6
Pullman	79¾	4	5

Stock	November Price	Div. rate in $	Approx. yield Per cent
Am. Car & Fdry.	81	6	7.4
Am. Locomotive	100	8	8
Am. Steel Foundries	45	3	6.6
Consol. Gas of N. Y.	93¼	4	4.3
Public Service of N. J.	68¾	2.60	3.7
Am. Tel. & Tel.	219⅞	9	4
Inter. Tel. & Tel.	70	2	2.8

Some Good Preferred Stocks

Railways:	Nov. 1929 Price in $	Yield Per cent
**Atchison, Topeka & Santa Fe	101½	4.93
Baltimore & Ohio	80	5.00
Bangor & Aroostook	108½	6.45
Buffalo, Rochester & Pitts. (1)	95	6.30
Buffalo & Susquehanna	72	5.56
**Chicago & Northwestern (1)	138½	5.05
Chicago, Rock Island & Pacific	105	6.70
**Chicago, Rock Island & Pacific	95	6.30
Cleve., Cin., Chic. & St. Louis	112	4.50
Colorado & Southern 1st	69	5.80
Colorado & Southern 2nd	69	5.80
Erie 1st	59	6.80
Erie 2nd	59	6.80
**Gulf, Mobile & Northern (2)	87	6.90
Illinois Central (4)	130	4.60
**Kansas City Southern	67	5.97
**Missouri, Kansas & Texas	99	7.07
**Missouri Pacific (3) (4)	121	4.20
New York, Chicago & St. Louis	106	5.66

Railways:	Nov. 1929 Price in $	Yield Per cent
**N. Y., New Haven & Hartford (4)	120	5.83
Norfolk & Western	87	4.60
Pere Marquette, Prior	94	5.30
Pere Marquette	93	5.40
Reading 1st	45½	4.40
Reading 2nd (4)	46	4.35
**St. Louis-San Francisco	90	6.60
St. Louis Southwestern	89	5.62
Southern Railway	97½	5.13
Union Pacific	81½	4.91
**Wabash Pfd. A (1)	90	5.56

Utilities:	Nov. Price in $	Yield Per cent
Amer. W. W. & El. 1st (n. p.), $6 cum.	100	6.0
Col. G. & E., A, 6% cum	102	5.9
**Consol. Gas N. Y. (n. p.), $5 cum	96	5.2
Duquesne Light, 5% cum	98	5.1
**Elec. Power & Lt. 1st (n. p.), $7 cum.	103	6.8
Eng. Pub. Ser. (n. p.) conv., $5 cum	86	5.8
Eng. Pub. Ser. (n. p.), $5.50 cum	90	6.1
Gen. G. & E., A (n. p.), $8 cum	116	6.9
Gen. G. & E., A (n. p.), $7 cum	100	7.0
Kansas City P. & Lt., B (n. p.), $6 cum	107	5.6
North Amer. (par $5), 6% cum	50	6.0
North Amer. Edison (n. p.), $6 cum	98	6.1
Pacific Tel. & Tel., 6% cum	133	4.5
**Phil. Co. (par $50), 5% non-cum	48	5.2
Phil. Co. (new, par $50), 6% cum	48	6.2

Utilities:	Nov. Price in $	Yield Per cent
**Postal Tel. & Cable, 7% non-cum........	96	7.3
P. S. El. & Gas, 6% cum........................	106	5.7
Public Service of N. J., 8% cum...........	141	5.7
**Public Service of N. J., 7% cum...........	119	5.9
Public Service of N. J., 6% cum........	100	6.0
Public Service of N. J. (n. p.), $5 cum..	94	5.3
Standard G. & E. (n. p.), $4 cum........	60	6.7
United Corp. (n. p.), $3 cum................	44	6.8
United Gas Impt. (n. p.), $5 cum........	95	5.3
**West Penn El., 1st, 7% cum................	100	7.0
West Penn El., 6% cum........................	91	6.6
**West Penn. Elec., A (n. p.), $7 cum....	97	7.2
West Penn Power, 7% cum....................	111	6.3
West Penn Power, 6% cum....................	103	5.8
Atlantic G. & W. I. (4)	54¾	7.3
Atlas Powder (6)	97	5.2
Bamberger (6½)	93½	7
Brooklyn & Queens (4)	44	9.1
Burns Bros. (7)	90	7.8
Chicago Pneumatic Tool (3½)...........	47	8
City Ice and Fuel (6½)........................	98½	6¾
Consolidated Film (2)	16½	12
Continental Baking (8)	30	10
Duplan Silk (8)	92	8.7
Federal Mining & Smelting (7)...........	97⅛	7.1
Glidden Co. (7)	95	7.4
Goodyear Tire Co. (7)	90	7.8
Grand Union (3)	30⅛	10
Ludlum Steel (6½)	76	8
McKesson & Robbins (3½)....................	40	8.5

Utilities:	Nov. Price in $	Yield Per cent
Maytag (6)	76¾	7.8
Metro-Goldwyn (1.89)	22	9
National Dept. stores (7)	91¼	7.5
J. C. Penney (6)	90.3	6.5
Remington Rand (7)	85	8.2
Safeway Stores	92½	6.4
White Sewing Machine (4)	32	12
Bethlehem Steel Corp. (7)	122	5.7
Mathieson Alkali Works (7)	123	5.7
Case (J. I.) Thresh. Mach. (7)	121	5.8
Deere & Co. (7)	119	5.9
General Cigar (7)	117	6.0
Brown Shoe (7)	114	6.1
Baldwin Locomotive (7)	115	6.1
American Locomotive (7)	115	6.1
Bucyrus-Erie (7)	112	6.3
Crucible Steel (7)	109	6.4
Bush Terminal Building (7)	108	6.5
Associated Dry Goods 1st (6)	93	6.5
International Silver (7)	106	6.6
Goodrich (B. F.) Co. (7)	104	6.7
American Sugar (7)	104	6.7
General Cable Co. (7)	103	6.8
Radio Corp. of Amer. (5)	71	7.0
U. S. Smelting, Ref. Mining (5)	50	7.0
Bush Terminal Debentures (7)	97	7.2
Spicer Mfg. Conv. (3)	41	7.3
Loew's Inc. (6½)	80	8.1

Chapter XXIII

Questions and Answers That Interest the Average Man

1. *"What do bankers mean when they talk about 'a business man's risk'?"*

They usually apply this term to stocks or bonds which have a considerable amount of speculative risk. They do not mean the first class common stocks, or even the second class. They mean common stocks or bonds which represent companies whose future is rather uncertain, or who have passed their dividends, or lost volume or profits, or who have very large funded debts, or are affected by adverse conditions in their industry. *I* would call these *speculations* pure and simple, and would not recommend them to investor-speculators, even if they are business men. The name "business man's risk" is just

another way of saying that they are unsound except as a gamble.

2. *Is it possible to acquire the "art" or "knack" of making a lot of money in stocks?*

This is a typical question from amateurs in investment. They have acquired the idea somewhere that there is some secret or genius about beating the stock market, and they like to imagine some "master" of the tape who "makes millions" in the market. This is not a true picture of the facts. Even the famous men (dead or alive) associated with stock market manipulation, such men as J. P. Morgan, (the elder), James R. Keene, E. H. Harriman, "Bet-you-a-million" Gates, W. C. Durant, Jesse Livermore, etc., have had serious losses in the stock market and have never demonstrated that they could make millions at will from it. Even the professional speculators, who know every screw and every twist of the stock exchange machinery and have years of daily experience behind them, are certainly not "masters of the market." The average man must give up the idea of acquiring some automatic "knack" at making money.

3. *Is it true that the stock market is simply a trap for small investors set by the big fellows who skim off the cream themselves and "unload" on us small fellows when they get ready?*

This is another ancient prejudice. It harks back to the days of Jay Gould and Jim Fiske who were simply "gentlemen crooks" using the stock exchange for a tool. The standards of our big exchanges are now very high and the market so large that "corners" and sizeable plots against the average investor-speculator are next to impossible. The whole theory of stocks is now different; the bankers want the public to do well with their stock purchases so that people will continue to invest. It is true that bankers have better opportunities to know good investments than others, but the volume of investment is so large that they can't possibly "hog" it all, even if they wanted to. Publicity is so great today that they have to operate in the open, subject to free criticism.

4. *Are there really good opportunities to pick up "bargains" in stocks, or is it simply a case of taking a chance on hopes and possibilities?*

At one time U. S. Steel preferred sold at 49—carrying the regular 7% dividend! Anybody—a bootblack or a bank president—could have bought it and made 14% profit on his money for the rest of his life. There are more bargains at present, in the general market decline, than there have been for twenty years.

5. *Isn't speculation, to any degree, unsound and immoral?*

Speculation is impossible to avoid by anybody. Your wife speculates when she buys a hat; speculates on the likelihood that she and her friends will like the hat. Sometimes she is disappointed! She speculated when she married you. All hope is nothing else but speculation, and if you want to take hope out of the world you might as well blow it up. You speculate when you sit in a restaurant and order your dinner; on the hope that it will please your palate. You speculate when you buy a theater ticket. Business, in particular, has much speculation in it. Even the professional speculator performs an economic service by watching values closely and keeping the market in motion so that it won't freeze up and lack flexibility. No, speculation is not unsound if by outright purchase.

6. *What is the difference between stocks listed on the New York Curb Market, and stocks listed on the New York Stock Exchange?*

The Curb market (which for years operated out on the street in Broad Street) does not require that the companies whose stocks are listed there furnish for publication an all-inclusive report concerning assets, earnings for a period of years. The New York Stock Exchange does

make this requirement; so that the investor can obtain plenty of information about stocks listed there ("the big board" as it is called). This does not mean, of course, that all stocks on the curb are to be distrusted; but it means that there is not the same intimate analyses possible for the investor, and therefore a higher degree of risk. Banks do not loan money so readily on curb stocks. As a matter of fact there is room for improvement even in the New York Stock Exchange requirements for information.

7. *What is a "bucket shop?"*

It is a so-called broker who when you order him to buy or sell stock does not do so, but acts as if he did. No broker should be employed unless he has been carefully investigated. He should be a member of the New York Stock Exchange, which enforces rigid rules.

8. *Don't brokers try to sell you stocks they are themselves promoting?*

I would advise that *no* broker's advice be taken as to what stocks to buy. An investment banker who is a professional student of investments and has standing and reliability, is the one to ask for advice. In particular no broker's advice offered on the telephone or by circulars should be given attention.

9. *What is "switching?"*

This is one of the oldest tricks. Someone tries to persuade you to turn over some high class stock or bond you own, in exchange for some other stock or bonds which offer supposedly more income or other advantages. Invariably turn these offers down, as they are simply tricks to give you a "gold brick" for your money.

10. *Why are some stocks which pay no dividends selling higher than other stocks which pay dividends?*

For the simple reason that the stock without a dividend may represent considerable value in the undivided surplus or intrinsic value of the company, or excellent likelihood of a dividend soon, due to increased earnings, whereas the low-priced dividend paying stock may represent a company which is still keeping up its dividend with difficulty, and whose earnings and prospects are declining. The dividend may be expected to be passed shortly.

11. *If I lose a stock certificate, what can I do?*

Immediately give the company formal notice of the loss, in writing, with a request to "stop transfer." Also send notice of the loss to the secretary of the exchange upon which the security is traded. In both cases give the *number* of the certificate. This makes it important for you

to have in your record book the number of each stock certificate you own.

12. *Is selling "short" ever advisable?*

Not for the average man. It is essentially a speculator's device, and the average man is never nimble-minded enough to reverse his position with the currents of the market. Furthermore, as I recommend being an *investor-speculator,* short selling is inconsistent with such a character. Buy at the right time for the long-pull, and then in "bull" markets reaching a peak, stay out of the market entirely.

13. *Is the "public always wrong?" And if so, doesn't it prove that the average man should not buy stocks?*

Of course "the public" is always wrong, just like a cattle stampede is always stupidly going in the wrong direction. A well-known Wall Street man once, as an experiment, in his son's name, operated a special account on a *"reverse"* principle; that is, bought stocks when the public was actively selling, and sold stocks when the public was actively buying. He found the method so reliable that he made a lot of money. The public is just like stampeding cattle—it can't be stopped from buying too enthusiastically, nor can it be stopped from selling in too much

of a panic. The recent boom and decline has been excellent evidence of this.

But I make a distinction between "the public" and the average man, the distinction being that I expect the average man and woman I am talking to in this book to subscribe to the *investor-speculator* plan, not the margin speculating idea which the general public is guilty of. The average man or woman should free himself from "crowd psychology." This is quite simple; study the advice of the cool heads; there is usually plenty of warning when a market is getting top-heavy, and only the hot-heads and "morons" are fooled.

14. *What is the "Pyramid" plan?*

This is a somewhat technical system not to be advocated for the average man. Operation of it calls for buying say 100 shares of an active stock, and buying 10 more at every one-point rise. If if moves only upward, no more margin will be required than for the first 100 shares, as the margin requirement is taken care of by the advance. In this way 200% profit accrues in a 14 point advance. A "stop order" is placed near the last top price on the scale. On a downward market of course the reverse situation results. There is a lot of technique in this operation.

15. *Are "stop loss" orders advisable?*

As a rule, no. Sudden swings downward and back up again bring losses in this way. The only justification for frequent use of the stop loss order is when a professional speculator uses it, under constant watching of the market, which the average man can't do. In case however you have an excellent profit in a certain stock and hope for more, but are ready to sell if a tendency downward develops, it is well to place a stop loss order, as it will protect you on a wide decline. Much "paper profit" might be saved if this was done in such instances.

16. *Should an average man touch mining stocks?*

He should absolutely avoid them, with the exception of coal and porphyry copper mines (but only such as are listed on the New York Stock Exchange), because in these mines the material is close to the surface and the value can be estimated accurately. Vast sums of money have been sunk by the public in mining stocks in the past, and the average man should turn his face like flint against them.

17. *What is the average man to do in the face of so many conflicting opinions on the market by the experts?*

This is to be expected. There is no "official"

or 100% right view of the market. If there were, everything would be cut and dried and there would be no gains and no losses. The market is created by differing opinions. When you feel like selling, somebody else must feel like buying, or else you can't sell! Don't worry about conflicting opinions, but I do believe in striking an average between them. That is why in this book I advocate for the average man a forecasting service of the type that merges all opinions into one and doesn't try to render mere personal opinions. There is too great a chance for error in personal opinions; and that is the real explanation of why they vary and conflict. Just before the October "break" in the market, Babson was predicting a great crash, while Prof. Irving Fisher was saying stocks were not too high. As a matter of fact, both were right, within limits of meaning. The average man must do a good deal of thinking for himself, but carefully study competent opinion.

18. *Are companies with large surpluses particularly desirable; also those which put a great deal of earnings back into the business?*

Some companies have huge surpluses, and if these are very well invested they have a large extra source of income, above their regular business. Union Pacific for instance earns 8% per share

on its investments alone. But some companies which put a lot of money back into the business are tempted to over-expand, to increase their production capacity too much. Companies which earn enough money to pay dividends but consistently avoid doing so should be passed by.

19. *How can one keep money liquid to await chances to buy stock bargains, and yet secure interest on it?*

By keeping your money in savings banks which do not have too rigid withdrawal notice rules; and also in state building and loan associations, which are virtually like savings banks. If you have more than two or three thousand dollars to hold, use several savings banks. Even if there are time limit rules, in a panicky market you will likely be able to persuade the bank officers to let you have the money at once, because an outright purchaser in a low market is a financial benefit to business. On larger sums, buy short time bonds or notes, or commercial paper or collateral lien notes. Trust companies or good private banks often pay 2 or 3% on checking accounts.

20. *Are "statistical sharps" and experts really wizards to be trusted in working out market opportunities?*

Here is a peculiar situation. Although Wall Street has a great many "statistical sharps" and

analysts, and a vast deal of figuring and calculating is done, the truth is that statistics in themselves are not the "royal road" to success in investment speculation. If they were, the "statistical sharps" would all be rolling in wealth instead of working for salaries! This is explainable by the fact that success with stocks is not primarily calculable by statistics. Mathematics is the science of measuring, but everything is not measurable by available statistics, nor are all needful statistics available.

But insofar as factors are measurable with figures they should be very closely studied. Management is measurable only by record of past results, and there are many things in the status of the industry, in management and in good-will which defy mathematical measurement. The statistician is invaluable as an aid in figuring averages, and calculating from known data, but business judgment and knowledge of men and markets and the public are most important qualities in judging the more intangible factors. The two elements together make the ideal form of analysis. It can be laid down as a rule that a statistical deduction should not be followed to its uttermost logical conclusion, because it is like an ideal mathematical straight line—it doesn't exist in reality. *Use* statistics, *hire* statisticians,

make no move *without* statistics—but always set judgment and common sense above them. I say this, even though I head a statistical organization of 22 years' standing.

21. *If one buys bonds, is not one free from risk?*

No; decidedly no! Even if there is no question as to the credit standing of the bonds—that is, no question of the value back of them—they are risks just the same, as we have discovered in recent years. These risks are (1) decreasing purchasing power of a dollar; (2) increase in present day interest rates; (3) possible alteration of credit risk in the company. Bear in mind that the purchasing power of the 1920 dollar was only 37% of the purchasing power of the 1902 dollar. Smith has worked it out that Chicago Milwaukee & St. Paul bonds bought in 1902 and sold in 1920 showed a total loss of over 80%! The bonds fluctuated in price like stocks, and all three factors mentioned here united to cut down the expectation. Common stocks however showed, in the same period, an increase of 16% on original investment.

22. *How is one to tell the real bottom of the swing?*

A *real* bottom is fairly unmistakable. It is in reality *a panic,* although in a panic there are

from two to five big "drops." It is true, there was some doubt about the October-November bottoms. The situation got four column and full page spread headlines in the newspapers; that was the clinching evidence of panic and of one or two bottoms. Any time that the stockmarket gets on the front pages of the newspapers because of a decline, you can make up your mind there's a low droop to the swing, and buying time, *not* selling time. There will then likely be one or two further *drastic* bottoms each one lower than the others. Usually the first very low bottom is not the *real* bottom; it will drop lower still—usually only for a period of a few hours, so that to catch it, it is necessary to be on the watch for it either by hourly watching or by orders placed at certain low points. "Bottoms" are usually extreme and sudden, with a fairly rapid rebound of ten or fifteen points, like the bounce of a ball. Any average drop of 15 points for all stocks is a mild panic, and may presage a coming real "bottom."

23. *Shouldn't one ignore the bulls and bears and the rigmarole about general up and down trends, and simply study the stock itself, on its merits?*

It is all very well to study intrinsic merit in particular stocks, but you can't get away from

the fact that the quotations of stocks are very directly affected by trends, irrespective of basic values. This is because *the part is never independent of or more powerful than the whole.* Also no one stock is more powerful than all stocks together. A perfectly good stock, with all the facts known about it, will sell for 65 this month and for 120 several months from now, without any new fact about it coming out; all due to the general market status. Yes, trends *are* important; particularly the trend in the *industry* represented by the stock.

24. *Is there such a thing as "scientific" investment-speculation?*

Hardly. To be scientific, a thing must be exact, and if you can't be exact in a matter it is not yet ready to be called a science. Nevertheless, that is no reason why *scientific method* cannot be applied just as far as possible. Common sense is only a less fancy name for scientific method, but to be scientific common sense must train itself to methods of exactness and use opinion only when it is not possible to get fact.

25. *What are the mistakes most frequently made by investor-speculators?*

First, trying to make money too fast, or get too high a rate of interest. Second, failure to make sufficient analysis of investments. Third,

over-confidence and indecision. Fourth, not making a sufficiently diversified investment.

26. *What are some of the qualities of mind and character most called for in successful investment speculation?*

Coolness of mind, fixity of purpose, clear thinking, business judgment, vigilance, caution, modesty, mathematical ability.

27. *What are some of the facts about previous great panics?*

Old-time panics date back to the famous "Black Friday" of September 24, 1869 when Jay Gould and Jim Fisk tried to corner gold. Then as an after-effect came the severe panic of April 1873, when 70 stock firms failed. In 1884 there was a bank panic; and in 1893 a very severe panic occurred, 13 stock firms failing, followed the next year with 15,000 failures. In 1895 another crisis came, caused by threat of a war with England. Money went to 80%.

Then in 1901, owing to the Harriman-Hill fight over the Northern Pacific, there was a mild panic, but in 1903 a fairly severe one came, due to over-flotation of stocks. The 1907 panic was still more severe, call money going to 125%, with bank failures, suicides and Government aid. It was due also to over-promotion and speculation.

Since then, it had been believed, we acquired some mastery over panics, as the July 30, 1914 scare was of course due to the war, and the Exchange was closed for 111 days. The "peace panic" of 1916 was also a war effect, as was the decline of prices in 1921 which brought disorder and failures. The 1929 "panic" was the first since 1907 which was "cyclic" and unconnected with a war. It broke history in rapidity of drop. In less than seven weeks the Dow-Jones industrial averages broke 39%, whereas the 1919 panic took 21 months to reach a 46% break. The pre-war liquidation took 15 months to drop 43%.

28. *What was the extent of the decline in stock values in October 1929, as compared with earlier breaks?*

The percentage of decline of stock values in various "stock panics" have been:

October 1929	23⅝%
March 1929	10%
December 1928	10%
June 1928	10%
February-March 1926	21¼%
April-May 1920	17⅜%
November-December 1920	24¼%
November 1919	15½%

29. ***Just how far down did the 1929 panic go?***

Take the Dow-Jones industrial averages as an authoritative measure. At "high" in September it stood 381.17. The decline running into November, touched a low of 198.69, which meant a decline of 182.48 points in ten weeks. This figures out a total loss of 47%. The rail loss was 32%.

But these are averages. About 350 New York Stock Exchange stocks *fell over 50%;* and 125 stocks declined more than 75%. Twelve went so far down as 90%, and one went down 97%!

30. ***"To what do those really in a position to know, attribute the big 1929 stock break?"***

It is a fair question. There has been a lot of balderdash talked of about the stock panic, and everything from the wrath of God to a ring around the moon has been named as the cause.

The technical facts are these: The thing began with the too large expectations of the automobile manufacturers, and the consequent over-bulling of their stocks. This was coincident with the same kind of over-bulling of the public utilities stocks, and then of investment trust issues. Meanwhile the expectations of the automobile man began to crumble during the summer, and consequently a hollowness began to develop under the advancing boom. Enough

profits had been made already on 1929 business to beat the 1928 record, in many instances, and from these premises great hopes for the future were built which the mundane facts did not warrant. The capital gain tax acted as a retardation of selling on the moderate rise, and this made the market artificial to a degree.

The investment trusts then blew more bubbles that were deceptive; bidding up stocks by their highly concentrated buying of certain good issues—ignoring the fact that 60% of other stocks were slipping downward, and then placing their funds on loan as call money and thus aiding still further to add more toplofty stories to the already dangerously high structure of the market.

Meanwhile the huge flow of capital toward the stock market enlarged the "hollow" under the boom. Building activity definitely suffered from lack of mortgage money; international finance felt the restrictions, and local business found bankers rather slow to loan money—large parts of their funds were in New York.

Somebody saw that hollow and uttered a warning. In fact the warnings were many, but they were not specific or analytical enough to cause concern. The Federal Reserve uttered it, but it did not utter it with firmness. Babson shrieked rather fanatically about it, but few really imag-

ined any such decline as came suddenly when confidence was lost.

31. *Do the low-priced stocks fluctuate less than the high-priced stocks?*

It is common belief that they do, but it is unfounded. A very thorough test of this was afforded in the recent panic. The decline of the low-priced stocks was the greatest in percentage —60.3%; whereas the high-priced stocks, although they dipped downward more *points,* did not dip down so low in percentage—only 49.5%. The public utilities of course suffered the greatest decline, as a class; but the greatest decline of any individual stock, 97%, was among the industrials.

32. *Are New York Curb stocks bad collateral with the banks?*

No. Possibly one-third to one-half of the Curb stocks are accepted by the banks as collateral on just about the same basis as New York Stock Exchange stocks. The Curb is improving rapidly; and about 700 shares are actively traded in. The chief defect is the lack of full information available about the stocks, although there is plenty of information about some of them.

33. *What are some good Curb Stock purchases?*

A dozen or more are very excellent bargains,

and will be during most of 1930. American Cyanamid B; Mapes Consolidated Mfg., Pepperell Mfg., David Reeves, Walgreen Stores, Driver-Harris, Ford Motor, Ltd., Libby, McNeill & Libby.

34. *To what extent are we likely in the future to have rapid up-and-down swings of the stock market?*

Just prophesying would be futile, but there is reasonable cause for expecting considerable stock fluctuation in the next two to five years. The reason is, as Col. Ayres, well-known analyst, has pointed out, that the stock market has learned how to be independent of credit control. By this he means that big business corporations have formed the habit of lending their reserves to the stock market on call, and this is outside of the control of the Federal Reserve system. In this way Col. Ayres believes—and I agree—that the stock market is less likely to be held down in its bull enthusiasms, particularly since our business corporations are more solid, and business itself is more independent of stock market fluctuations. By the same token, the stock market will more suddenly swing *downward,* as it did in 1929. As Col. Ayres puts it "bull markets now tend to suddenly commit suicide."

So my answer is, look out for fluctuations, which will continue; and be prepared for them.

35. *Much information is offered as to when to buy, but tell me when is the right time to sell?*

A fair question. Broadly speaking, of course, if you become convinced, and the best opinion agrees, that the whole general market is nearing a high peak (as it was early in September 1929), you should *sell everything you own.* Don't let any peculiar sentimental attachments to the particular stocks you own stand in the way. *Sell*—every stock you own. You can later buy back your favorites, very cheaply.

But this is for a peak-time which arrives but once every three or five years. Should you sell at any other time? No, not everything you own. But sell those particular issues (1) which are in industries going backward; (2) which are losing their status in the industry; (3) which are falling behind in earnings steadily; (4) which, if replaced with stocks with brighter prospects, would better your prospects, (5) which are being promoted and inflated too rapidly, or otherwise mismanaged.

36. *Will not stocks go back to the pre-panic level sometime?*

Forget it. One of the most fundamental errors is to fail to grasp what the action of a panic

like this means. *It means that a great many of the valuations made by stock prices at the high peak were dead wrong; unsound and out of line with fact.* Therefore if your mind clings to the idea that the drop in prices was a mere erratic action, you are playing with fire; you are thinking that values are alive which in reality are *dead.* Quite possibly values for some stocks will reach and even go beyond the prices of the peak. But if they do it will be because new factors not now visible will logically take them there. Many stocks are undervalued today, that is certain, but even a fair rise will not take them to the peak. We must forget the peak prices entirely —ear-marking them as *false values,* in large part.

37. *How long has it taken in previous "panics" for recovery?*

Panics differ in kind and intensity. The 1920 depression, based on great overloading of stocks, took 1½ years for recovery; the worst part occurring six or eight months after the "panic" on the stock exchanges.

In 1908 the recovery was quite prompt from the October 1907 panic. A "boom" period was under way by 1909; although it did not last.

After the very severe 1893 panic there were two whole years of depression. In each of the

last two panics named above, there was a *false* recovery which did not last, and was followed by renewed depression.

38. *I am a dumbbell, no doubt, but will you please explain to me how the margin trading in stocks actually works? I don't understand it?*

A transaction on the floor of the New York Stock Exchange is always in "street certificates" which means a blank name, and its authority is the signing officer of the last broker handling the certificate. This facilitates the quick movement of stocks.

80% of stocks are today sold on margin, even though four or five times as much margin is required today as before. Scarcely more than ten years ago, the margin requirement was only about 10 or 15%; today it is usually 50%. What is meant by this you can see in a particular example of a stock selling at (let us say for example) at 100. To buy outright 100 shares of this stock at $100 per share would require $10,000. You would simply pay this sum and receive the stock certificates, and be registered on the books of the company as a stockholder.

But as a "margin buyer" you do not get the certificates—you pay 50% of the price—$5,000—to your broker, who buys it, notifies you of the price paid, plus broker's commission and the

state tax. Using the stock you have purchased, the broker borrows $5,000 more on it from "the money crowd" on the Stock Exchange floor, thus making up the total purchase price. Brokers borrow money in large lumps of $100,000 at one time to handle many such transactions. At the end of each month the interest charge is computed, and deducted from your balance. It represents the current renewal rate, plus an overhead charge of 1 or 2%. The broker himself has the shares, but he may lend them to another broker at "call money" rates. The "calls for margin" from the broker are simply calls for sufficient money to keep the sum put up by the buyer at the same ratio of 50%.

If you buy 10, 20, or 50 shares on margin, instead of the standard 100 share lot (the only unit the New York Stock Exchange will trade in), then an "odd lot broker" acting on your broker's commands, will assemble other fractional buying orders, until he has a total of 100, and then go on the Exchange to buy. There is now much more odd lot buying, so that this works quite smoothly but naturally not so fast.

"Exhausting" your margin simply means that if the stock bought at 100 declines to 50, you are "wiped out"—unless you can produce $2,500 more margin, which would then re-margin you at the standard 50% ratio.